

ECONOMIC POLICY COMMITTEE

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## **ANNUAL REPORT ON STRUCTURAL REFORMS 2003**

“Shifting up a Gear. The Case for Speeding up Reform”

## Preface

Ongoing structural reform is a central feature of the EU's agenda. It has to be so if member states are to deliver to their citizens continuing and improving material and social well-being. Sustained progress is essential if the ambitious goals set in Lisbon are to be achieved.

In accordance with its statutes, the Economic Policy Committee has a duty to report each year on the progress that the Union has made. It does so as a frank friend, noting where progress has been achieved but also drawing attention to areas where progress has been less satisfactory and where efforts need to be reinforced.

The current Report was adopted by the EPC on 25 February 2003. It was underpinned by a peer review of structural reform in the product, capital and labour markets of each Member State. This review was carried out by a working group of the EPC under the chairmanship of Joe Grice. The European Commission Spring Report and BEPG Implementation Report were of particular importance as information sources and the European Commission played a full part in this exercise and provided in depth support, which the EPC gratefully acknowledges. With regard to the *key challenges* that Member states face, there is a high level of agreement between the EPC, as expressed in this Report, and the Commission, as expressed in its BEPG Implementation Report.

This year, the scrutiny focused on early retirement schemes as the special topic. This is a pressing subject that has relevance for the Lisbon, Stockholm and Barcelona objectives for employment and participation, and also for fiscal sustainability, within a Union with an ageing population.

The first few pages of the Report summarise its key messages. These cover a variety of areas. But the underlying essence is as follows:

- Progress with structural reform has continued in 2002. Countries have taken a number of further measures
- The benefits of these and previous reforms are starting to come through, as shown, for example, in the pleasing resilience of EU labour markets at a time of difficult world conditions
- Nevertheless, the pace of reform has undoubtedly slackened, and employment remains too low, especially for older workers.
- As a result, reform is now too slow and insufficient. The pace needs to be quickened substantially if the Lisbon objectives are to become within reach.

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## **Key messages on progress towards the Lisbon objectives**

The EU in Lisbon in March 2000 set for itself the strategic goal *to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion*. Subsequently, the target was extended and clarified by the European Council contributions in Stockholm and Barcelona. The overall EU target for employment participation by 2010 was set at 70 per cent against the current level of 64 per cent. As a measure of the task on competitiveness ahead, the United States currently has productivity some 20 per cent higher than the Union's average. GDP per capita is much lower than in the United States.

The Economic Policy Committee has carried out detailed **peer review examinations** on structural reforms in product, capital and labour markets in the Member States of the European Union. The purpose of these examinations is:

- to assess progress against the strategic goals; and
- to clarify how best progress can be accelerated.

Clearly inspired by the strategic Lisbon goal, Member states have taken a number of measures to reform labour, product and capital markets, to foster the transition to the knowledge-based economy, to ensure environmental sustainability and to promote public sector efficiency. The positive effects from reforms already undertaken are clearly emerging. Yet, the pace of reform has undoubtedly slackened and is now **too slow and clearly insufficient**. A marked acceleration of reform is required for the strategic Lisbon goal to become within reach. This would also promote resilience against adverse economic shocks and – by fostering confidence among consumers and investors – improve the pre-conditions for speeding up recovery in the present difficult conjunctural circumstances.

Member States broadly agree on the key challenges facing them, also set out in the Commission's report on the Implementation of the Broad Economic Policy Guidelines. The task ahead is the determined implementation of the most appropriate measures, notably in those areas where progress is not satisfactory. Member States should stand ready to take additional measures promptly. At heart, accelerating reform requires political will. Building up the political constituency for reform is therefore essential. There is much to learn from Member States where particular structural reforms have shown to be especially successful and where political support for further reforms is consequently strong.

While measures to be taken in Member States must vary according to their specific situation, from the country examinations the following key messages emerge:

1. As long recognised, **labour market reforms** are absolutely crucial to foster job creation, reduce structural unemployment and increase labour supply. Institutional arrangements in the labour market often need to be modernised, in co-operation with the social partners according to national practice, ensuring an appropriate balance between flexibility and security. National wage developments need to be consistent with price stability, taking duly account of productivity developments. Reforms need to promote active job searching and diminish obstacles to job creation, which arise among other reasons from the level, duration and/or eligibility criteria of benefits, overly restrictive employment protection legislation and inflexible wage bargaining systems that do not allow wages to evolve according to productivity and skills

differentials. In addition, both the efficiency and coverage of active labour market measures needs to be improved and mobility encouraged. Notwithstanding recent progress, continued efforts are needed to render tax and benefit systems more employment friendly. Without further reform the Lisbon targets will be missed and the unemployed and socially excluded will ultimately pay the price.

2. Regarding **product markets**, central issues are:
  - Strenuous competition should hold across the economy. Strong independent competition authorities are necessary in this respect. Competition was found to be insufficient in a number of business sectors, notably in certain service sectors, frequently reflecting inappropriate public regulation.
  - Internal market obligations, notably with respect to achieving the EU Directive transposition rate target need to be urgently addressed.
  - Progress in liberalising network industries has been found in all Member States. Some Member States should step up their reforms in order to ensure an EU-wide level playing field for network industries. Member States should address insufficient competition in newly liberalised markets through effective competition-oriented regulation and promoting interconnectability of energy markets. Additionally, Member States should increase consumer involvement in the process of liberalisation as a means to foster competition, to ensure the maximum benefits for consumers are obtained.
  - Further action on completing the single market in services is needed, if the Lisbon targets are to be met.
  - Policies on entrepreneurship should increasingly focus on the growth phase of businesses, as well as start up rates. The administrative burden on business, notably SMEs, needs to be reduced further. Some progress has been made to speed up and clarify bankruptcy and insolvency procedures and to reduce the stigma on failure that still prevails in most Member States. But progress is patchy and more needs to be done.
3. In order to promote **capital market** integration, further progress at the EU level, notably with respect to the implementation of the Financial Services Action Plan and the Risk Capital Action Plan, is key. Determined implementation should lead to an effective integrated European market for financial services. Progress has been made in the reorganisation of market supervision, but the task is far from complete. Increased consolidation in the financial services market in most Member States clearly demonstrates the need for completing an EU wide market for financial services, also with a view to improving effective competition.
4. As regards the **knowledge-based economy**, priorities should be to create conditions for investments in business R&D and to promote university/business links. Member States and in particular the business sector need to make further progress towards the Barcelona aim of 3% of GDP expenditure on R&D and innovation, two thirds of which is to come from the private sector. An efficient education system is of central importance for achieving permanently higher productivity growth and to provide a supply of appropriately skilled workers. The number of science graduates should increase to meet demand. While offering personal development opportunities, educational systems should be focused on quality outcomes and be more closely attuned to labour market needs. The creation of a business friendly Community patent, is urgently needed to improve incentives to invest in R&D. There needs to be

provision of a robust intellectual property regime. Reforms in labour, product and capital can contribute to foster the knowledge-based economy. Greater competition product markets is needed to stimulate innovation by removing the scope for complacency and inefficiency and increasing the pressure on firms to innovate. As are reforms to provide more accessible low-cost capital markets.

5. Member States are taking steps to ensure **appropriate protection of the environment**. Such actions should be based on a thorough analysis of costs and benefits. Some countries are making increasing use of market based instruments to ensure that environmental objectives are reached in a cost efficient manner and with minimum distortionary effects. These examples should be copied more widely.
6. The **public sector** accounts for a large share of the Union's economy, as well as providing the infrastructure for the rest of the economy. This makes efficiency in this sector particularly important. This should be achieved inter alia by increased cost-awareness by the use of outsourcing, increasing freedom of choice and by incalculating business-like financial management and accounting. Attention also needs to be given to dismantling barriers to open public procurement, critically assessing the use of all state aid, and the promotion of e-government. While maintaining budgetary discipline, productive public investment should proceed at rates necessary to underpin longer-term economic growth.
7. This year special emphasis has been put on policies to **raise the average effective retirement age** in the EPC country examinations. Regrettably, the progress towards the target set in Stockholm for increasing the average EU employment rate among older women and men (55-64) to 50 percent by 2010 is very limited and unlikely to be reached at the current rate of progress. In addition, while the average effective retirement age has risen slightly, it is still far from the Barcelona objective of an increase of about 5 years. Although all Member States have taken measures aimed at promoting labour market participation of older workers, it is still doubtful whether these policies will be sufficient to reach the Stockholm target. Therefore in some Member States further measures are necessary to reach the targets. Scope for further improvement is to be found in moving unduly favourable pension systems towards actuarial neutrality, and in tightening up early retirement schemes, - both reducing replacement rates and tightening eligibility rules, notably for unemployment and disability schemes that often lead to early retirement. Achieving the Stockholm target for participation of older workers will also critically depend on the progress made in further reforming labour, product and capital markets. In view of the budgetary pressures the Union faces, it is essential that measures to limit early retirement and to promote active ageing are cost effective.

**PART I**  
**STRUCTURAL REFORMS IN THE EUROPEAN UNION**

## **Meeting the strategic Lisbon goal**

Since heads of government and state met in Lisbon in March 2000 to define the well-known strategic goal for the European Union, almost one third of the time has elapsed for implementing the necessary measures to become the most competitive and dynamic knowledge-based economy in the world in 2010. These measures would encompass reforms in labour, product and capital market, the transitions to a knowledge based economy, sound environmental policies and the promotion of public sector efficiency. In Lisbon it was stated that if these measures are implemented against a sound macro-economic background, an average economic growth rate of around three percent should be a realistic prospect for the coming years.

In the first three years of the implementation of the Lisbon strategy annual economic growth rates of around 3 percent have not emerged for most Member States. Although it is clear that globally unfavourable macro-economic conditions have to be blamed for the relatively weak economic performance in the EU, this is only part of the story. It is likely that the failure to implement structural reforms timely and properly is equally responsible for this. Under the current circumstances for a re-acceleration in the US economy may still be key to stronger economic growth in the EU. Clearly the EU economy has not yet displayed the resilience desired by the heads of state and government of its Member States.

**Table 1 – Labour productivity and employment growth in the period 1996-2002**

	EU-15	US	Japan
Labour productivity	7.6 %	14.2 %	8.8 %
Employment	8.9 %	9.5 %	-1.7 %

*Source: European Commission Economic Forecasts, Autumn 2002*

From table 1 it shows that the US have outpaced the EU in promoting labour productivity as well as in creating jobs in the period 1996-2002, even if job growth has been stronger in the EU since 1998. This strong performance is the more so remarkable as the US also started from higher levels on both indicators in 1996. GDP in PPS per person employed was already 17 percent higher relative to EU-15<sup>1</sup>. The US employment/population ratio then stood at 72.9 percent, compared to the EU level at 60.2 percent<sup>2</sup>. Both labour productivity and employment growth are key indicators for monitoring the progress of the Lisbon strategy; the above figures clearly underline the challenges and tasks ahead<sup>3</sup>.

Structural reforms are no end in itself. Over the past years some reform fatigue has been observed in many Member States. The message “further reforms are needed” is insufficient; the rationale behind implementing structural reforms should be put more to the forefront. Firstly, structural reforms aim to produce benefits for consumers by reducing prices and/or increasing choice and quality of services. Past experiences have shown that is extremely important to involve the population in the reforms and to communicate the intended results. Some Member States, in particular Sweden, seem to have been successful in communicating the advantages to their citizens. Secondly, structural reforms – in particular labour market reforms – increasing employment rates in

<sup>1</sup> EU structural indicators, Eurostat

<sup>2</sup> OECD Employment Outlook, June 1999

<sup>3</sup> Due to higher population growth in the US, the US employment/population ratio only rose by 0.2 %-points to 79.3 percent in 2001, whereas the EU ratio rose by 3.8 %-points to 64.1 percent in 2001.



line with the Lisbon target - will bring benefits through increasing individual income and reducing social exclusion. Increased employment is also an end to securing long-term sustainability of public finances, thereby safeguarding welfare for future generations. Thirdly, the macro-economic rationale behind reforms should not be lost out of sight. With a single monetary policy and national fiscal policies that have to be performed according to the rules of the Stability and Growth Pact and taking into account the soon rapidly rising costs following the ageing of the population, shock absorption has to be increasingly realised by flexible markets.

## **1. Labour market reforms**

As long recognised, **labour market reforms** are absolutely crucial to foster job creation, reduce structural unemployment and increase labour supply. Institutional arrangements in the labour market often need to be modernised, in co-operation with the social partners according to national practice, ensuring an appropriate balance between flexibility and security. National wage developments need to be consistent with price stability, taking duly account of productivity developments. Reforms need to promote active job searching and diminish obstacles to job creation, which arise among other reasons from the level, duration and/or eligibility criteria of benefits, overly restrictive employment protection legislation and inflexible wage bargaining systems that do not allow wages to evolve according to productivity and skills differentials. In addition, both the efficiency and coverage of active labour market measures needs to be improved and mobility encouraged. Notwithstanding recent progress, continued efforts are needed to render tax and benefit systems more employment friendly. Without further reform the Lisbon targets will be missed and the unemployed and socially excluded will ultimately pay the price.

The Lisbon strategy is designed to enable the Union to regain the conditions for full employment (conclusion 6). To this end the Lisbon and Stockholm Councils set clear EU wide targets for employment rates for women and older workers in 2010 and intermediate targets for January 2005. These goals as well as the employment rates in 2000/2001 have been summarised in table 2.

**Table 2 – Employment rates and targets in the EU-15**

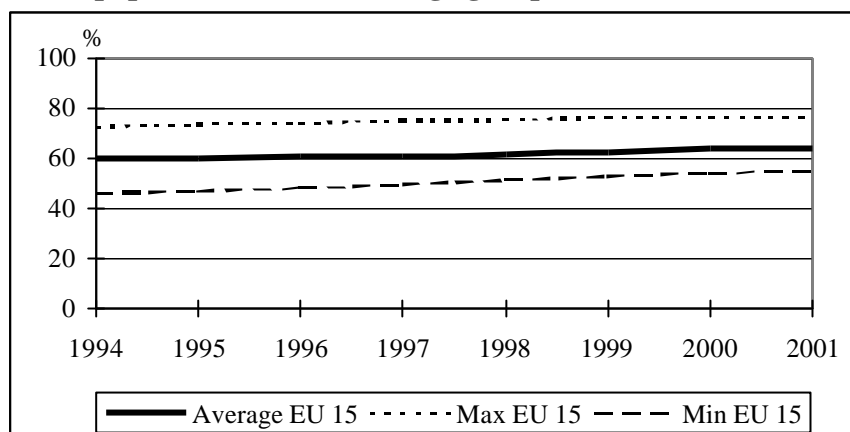
	2000	2001	2005 (target)	2010 (target)
Total (aged 15-64)	63.4	64.1	67	70
Women (aged 15-64)	54.1	55.0	57	60
Older workers (aged 55-64)	37.8	38.8	-	50

*Source: EU structural indicators, Eurostat*

Although the aggregate figures in table 2 may suggest that the EU is, with the exception of participation of older workers, well on track in meeting the Lisbon and Stockholm targets, they conceal some more worrisome developments. In the first place, employment creation has not been particularly strong in 2002; in Germany it was even negative. Therefore it is unlikely that the observed strong increase in labour market participation since the mid 1990s has continued after 2001. And according to the Commission's Autumn Forecasts, prospects for employment creation are not particularly favourable for 2003 and 2004 either. Secondly, there are wide differences between Member States in their scores on the employment targets. Only three Member States, Denmark, Sweden and the UK, are

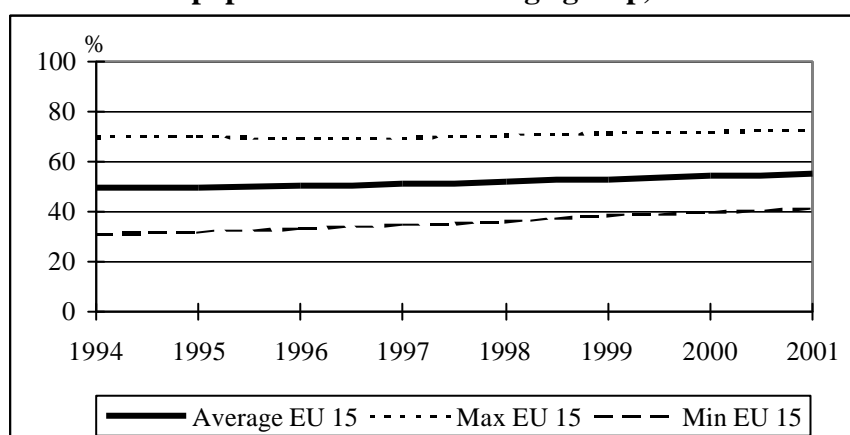
already meeting the Lisbon and Stockholm targets. The figures 1a-c plot the best and the worst performing Member State as well as the EU average in the period 1994-2001.

**Figure 1a – Total employment rate 1994-2001 (employed persons aged 15-64 as a share of the total population of the same age group)**



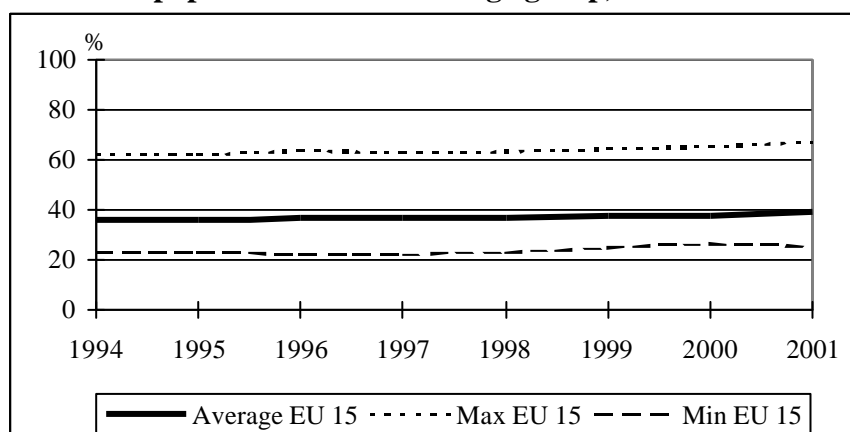
Source: EU structural indicators, Eurostat

**Figure 1b – Female employment rate 1994-2001 (employed women aged 15-64 as a share of the total female population of the same age group)**



Source: EU structural indicators, Eurostat

**Figure 1c – Employment rate older workers 1994-2001 (employed persons aged 55-64 as a share of the total population of the same age group)**



Source: EU structural indicators, Eurostat

It appears that wide differences in employment rates exist among countries. In 2001 the gap in total employment participation levels between the best performing Member State (76 %) and the worst performing Member State (55 %) amounted to 21 percentage points. These gaps are even larger for female participation and participation of older workers, amounting to 32 and 42 percentage points respectively. Although these gaps have been narrowing for both the total and the female participation rates since 1994, the gap for older workers has remained unchanged at a persistently high level. Also the increase in the average EU labour market participation of older workers has been relatively slow compared to the increase in total and female labour market participation.

Policies to encourage labour market participation of older workers, which were a special subject in the national Cardiff reports 2002, are discussed in more depth in part III of this Annual Report. From the national contributions it appears that many Member States have implemented policies to limit unwarranted early retirement. Old-age pension systems have been made more employment-friendly by introducing modifications allowing for greater actuarial fairness, in some cases by rewarding additional time in employment. Since the objective of limiting early retirement should also be seen as contributing to long-term fiscal sustainability, policy measures to this end should be cost-effective. From the EPC country examinations it appeared that reducing replacement rates and tightening eligibility rules, notably for unemployment and disability related early retirement schemes, matter. In some Member States, further measures are clearly necessary, if the Stockholm participation target for older workers is to be reached. This will also critically depend on the progress made in further reforming labour, product and capital markets.

Labour market reforms should aim at raising the employment level. Employment is the best safeguard against social exclusion, as was stated by the Nice European Council. Important areas for further labour market reforms that have emerged during the EPC country examinations include the level, duration and/or eligibility criteria of benefits, overly restrictive employment protection legislation and inflexible wage bargaining systems that do not allow wages to evolve according to productivity and skills differentials. In addition, the efficiency of active labour market measures needs to be improved. Special emphasis was put on the need for institutional modernisation, thereby also involving the social partners.

Over the past years the Broad Economic Policy Guidelines urged Member States to “reform tax benefit systems in order to make work pay”. Most Member States have responded to this guideline by reducing tax rates either across the board or targeted at specific groups. Although there is further scope for tax reforms, especially by reducing marginal tax rates at the lower end of the labour market, policies to make work pay should not neglect **reforms of benefit systems**. In this respect it is important to echo the Broad Economic Policy Guidelines 2002<sup>4</sup>. “Member States should, in particular, take the following measures: [...] Address incentive effects of benefit schemes, such as conditionality of benefits, eligibility, duration, the replacement rate, as well as availability of in-work benefits and the use of tax credits, in order to make the systems more employment friendly.”

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<sup>4</sup> Council Recommendation of 21 June 2002 on the Broad Guidelines of the Economic Policies of the Member States and the Community (doc. nr. 10093/02), page 18.

**Employment protection legislation (EPL)** affects labour market dynamics<sup>5</sup>. However, EPL may serve a useful purpose in providing insurance to employees where the market (including individual employment contracts and collective bargaining) fails to do so. Also it need not have a negative impact on total employment and/or lead to higher unemployment, provided that it is well designed and not overly restrictive. In general, it is important to have a good balance between flexibility and security. In most Member States less than optimal elements in EPL have been detected, such as complicated administrative procedures and unduly long minimum notice periods. Overly restrictive EPL proves bad for productivity growth and leads to higher long-term unemployment. In addition it may adversely affect marginal groups in the labour market, in particular young people, while benefiting core ‘insider’ groups, such as prime-age men. Some good examples on EPL have been reported from countries, e.g. Denmark, where a combination of relatively loose EPL, relatively generous unemployment benefits and well-designed active labour market policies has produced impressive results.

Institutional features of the labour market, together with macro-economic instabilities and badly regulated markets, explain the persistence of regional disparities<sup>6</sup>. These disparities both in income and unemployment may at least partly be due to **wage bargaining systems** failing to respond to regional and local labour market conditions, including productivity developments. Wage agreements could take better account of regional differences in productivity either by effectively decentralising the bargaining system to the regional or firm level or by introducing more flexibility in sector-wide agreements leading to greater wage differentiation. The Commission found that “in some of the more decentralised Member States there has been progress on decentralising wage bargaining towards more plant-level deals. However, this decentralisation often remained rather formal so that the actual outcome of agreements is still similar across regions.”<sup>7</sup> In spite of a clear recommendation in the BEPGs 2002<sup>8</sup>, and acknowledging the role of the social partners, no evidence has been recorded of thorough reforms in the wage bargaining systems during the EPC country examinations. In addition to greater regional wage differentials, measures that enhance **labour market mobility** can bring about lower regional disparities. Member States have been taken action to increase geographical mobility, inter alia, by strengthening eligibility criteria in the unemployment benefit systems or by introducing tax deductions for travel expenditures. Despite recent efforts, there is still ample room to increase both the coverage and the efficiency of these measures.

**Active labour market policies (ALMPs)**, commonly rubricated in training, employment subsidies and job search assistance, have gained in importance in labour market policies in the EU<sup>9</sup>. EU countries spend around 1 per cent of GDP on ALMPs according to OECD statistics which implies that ALMPs expenditure as a share of total spending on unemployment has risen by 40 per cent between 1985 and 2000. Spending patterns differ

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<sup>5</sup> See also Employment protection legislation (note to the Economic Policy Committee) of January 4, 2002 (doc. nr. ECFIN/02/003). The Economic Policy Committee discussed this note on January 9, 2002.

<sup>6</sup> See also Paper for the Economic Policy Committee on regional disparities in the EU – Main economic problems, determinants and orientations of September 21, 2001 (doc. nr. ECFIN/01/472-EN Rev. 1). The Economic Policy Committee discussed this note on November 21, 2001.

<sup>7</sup> Ibid., page 9.

<sup>8</sup> Council Recommendation of 21 June 2002 on the Broad Guidelines of the Economic Policies of the Member States and the Community (doc. nr. 10093/02), page 14.

<sup>9</sup> See also A review of evaluations of the effectiveness of ALMPs – A background document to the ongoing EES evaluation (Note for the Economic Policy Committee) of April 15, 2002. The Economic Policy Committee discussed this note on July 4, 2002.

widely across the EU, with markedly higher shares noted in Denmark, Ireland, Italy, Portugal and Sweden. ALMPs help to address inherent problems in the labour market like youth and long term unemployment by improving human capital and the matching process, and promote people remaining within the labour force also during periods of unemployment. ALMPs may constitute an effective test of availability to take up employment, but may on the other hand also reduce job search intensity. Some employment subsidies can also create substantial dead-weight losses, substitution and displacement effects. The latter refers to the effect that subsidised employment in one enterprise has on competition and on employment in other firms in that sector. In some Member States the crowding out effect (combined dead-weight loss and substitution effect) can be as large as 90 percent.<sup>10</sup> Empirical evidence on the effectiveness of some programmes, notably training and direct job creation in the public sector, indicate that these programmes have been less effective than other measures. Eight countries (D, EL, E, I, P, Fin, S and UK) received a country specific recommendation in the BEPGs 2002 to improve the effectiveness and/or efficiency of their ALMPs. According to the Commission in four countries (EL, I, P and Fin) ALMP reforms were in progress, whereas Sweden fully implemented the recommendation<sup>11</sup>.

## **2. Product market reforms**

Regarding **product markets**, central issues are:

- Strenuous competition should hold across the economy. Strong independent competition authorities are necessary in this respect. Competition was found to be insufficient in a number of business sectors, notably in certain service sectors, frequently reflecting inappropriate public regulation.
- Internal market obligations, notably with respect to achieving the EU Directive transposition rate target need to be urgently addressed.
- Progress in liberalising network industries has been found in all Member States. Some Member States should step up their reforms in order to ensure an EU-wide level playing field for network industries. Member States should address insufficient competition in newly liberalised markets through effective competition-oriented regulation and promoting interconnectability of energy markets. Additionally, Member States should increase consumer involvement in the process of liberalisation as a means to foster competition, to ensure the maximum benefits for consumers are obtained.
- Further action on completing the single market in services is needed, if the Lisbon targets are to be met.
- Policies on entrepreneurship should increasingly focus on the growth phase of businesses, as well as start up rates. The administrative burden on business, notably SMEs, needs to be reduced further. Some progress has been made to speed up and clarify bankruptcy and insolvency procedures and to reduce the stigma on failure that still prevails in most Member States. But progress is patchy and more needs to be done.

Numerous references have been made in the Spring Council conclusions and the various contributions thereto about the importance of **effective and strenuous competition**. In the Ecofin Key Issues Paper for the Barcelona Council it is e.g. stated that: “Measures to

<sup>10</sup> Ibid., page 6.

<sup>11</sup> Report on the Implementation of the 2002 Broad Economic Policy Guidelines of January 14, 2003 (doc. nr. COM(2003) 4/3)

liberalise, open up, integrate and build competition in European goods and services markets contribute to a truly flexible productive system, able to direct resources where they can be most profitably employed and so boost production, employment, income and welfare. This conviction is shared by all EU Member States and is the spirit behind the ambitious economic reform agenda set by the Lisbon summit.” Promoting competition is thought to contribute to all three pillars of the Lisbon strategy: economically, socially and environmentally. Also the creation of a competitive environment is considered key in fostering innovation<sup>12</sup>.

**Strong and independent competition authorities** are a prerequisite for enforcing effective and strenuous competition. Discussions during the EPC country examinations centred around the ability of competition authorities to fully apply the articles 81 and 82 of the Treaty, adequate staffing and resources, and the executing powers inter alia by imposing fines and penalties. Most Member States have made considerable progress in these fields, although in some Member States further reforms, sometimes of a purely legal nature should be pursued. The Finnish competition authorities do not yet possess the formal powers to directly apply articles 81 and 82 and in the Netherlands a debate on the law that would establish an independent status of the general competition authority has been blocked (temporarily) in the Upper House. However in both cases no apparent practical problems in enforcing EU competition policy have yet been detected. The enforcement of the Finnish competition policy was strengthened by the establishment of the Market Court. Austria has responded to the call for stronger competition authorities by installing an independent competition authority. Furthermore emphasis has been put on improving the transparency of the supervisory structure: the co-existence in some Member States of a general competition authority along with sectoral and/or regional supervisors may blur effective supervision and should require further attention, depending on the assignment of competencies between competition authorities and sectoral regulators. Ireland streamlined the organisation of its competition authorities.

In addition to establishing strong and independent competition authorities, strenuous and effective competition requires a level playing field, notably by fulfilling the **Internal Market obligations**. In this respect it was considered disappointing that the Stockholm interim target to transpose 98.5% of all internal market directives into national law had only been met by five Member States at the end of 2002 (DK, NL, FIN, S and UK). The more so because rather than approaching the target, the transposition rate has declined in 2002. Efforts clearly need to be stepped up. It is therefore recalled that the Barcelona Council called on Member States to make further efforts to meet that target and for a transposition target of 100% to be achieved by the Spring European Council in 2003 in the case of directives whose implementation is more than two years overdue.

The **liberalisation of network industries** has again received much attention during the EPC country examinations. On November 25, 2002 the Transport, Telecommunications and Energy Council reached a political agreement aimed at accelerating the liberalisation of the gas and electricity sectors. The agreement covers a timetable for market opening with deadlines on July 1, 2004 for non-household users and July 1, 2007 for household users, and provisions on unbundling of transmission and distribution system operators aimed at preventing cross-subsidisation. An important hurdle in the liberalisation of

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<sup>12</sup> See also the first recommendation in the EPC report Research and Development of January 22, 2002 (doc. nr. EPC/ECFIN/01/777-EN Final, 5402/1/02 REV1)

energy markets has been taken by this agreement. This implies that in some Member States efforts will have to be intensified to meet these deadlines. It should however be realised that liberalisation per se will not necessarily create the envisaged advantages for consumers. Improving market contestability by reducing all (potential) barriers to foreign and domestic competition and ensuring effective and transparent supervision structures are key in this respect. Other network sectors where during the EPC country examinations problems and/or insufficient competition appeared at both the EU and the national level include postal services and railways and to a lesser extent air transport (slot allocation) and telecom.

The **services sector** appears a weak spot in EU economic development. Productivity growth is low, innovation is limited and many barriers to their free circulation persist. Barriers are often of a legal nature or arise from the behaviour of administrations, including the use of discretionary powers or heavy and non-transparent procedures, which favours domestic operators. This is partly due to the complex and intangible nature of services and the importance of the know-how and the qualifications of the service provider, which complicate the rules for the provision of services. The EPC country examinations showed that many countries are facing the same challenges. In this respect it is good to note that the first stage of the Internal Market Strategy for Services, which made an inventory of Internal Market barriers, has been finalised<sup>13</sup>.

The maintenance and fosterage of competitiveness of industries is a central issue and a precondition for the safeguard and the maintenance of employment and income in Europe. Industry and its related services contribute to the assurance and creation of new jobs by their mutual interdependence. In this respect, the legal environment has a decisive impact on the competitiveness of the economy, also in comparison to its main competitors. A market and competition based industrial policy has the task to ensure a balanced approach, so that provisions in other policy fields are consistent with global competitiveness of industries and enterprises.

Most Member States have taken measures to improve the **entrepreneurial climate**, which may have benefited the number of business start-ups. Examples of such measures include the introduction of one-stop shops for business advice, reduction in time to set up a business and favourable tax rules for small businesses. This may have contributed to the shift of the entrepreneurial bottleneck from the start-up phase to the early growth stages of businesses. In this respect the UK's commitment to provide extra support to tackle barriers to small business growth in skills, finance and innovation is commendable. A related issue that emerged during the EPC country examinations is that many Member States are currently working on a modernisation of their bankruptcy laws. These reviews generally aim at making a clearer distinction between compulsory winding up (aimed at liquidation) and the moratorium (aimed at recovery). Measures focus inter alia on the conditions for entering a moratorium, a clarification of the roles of the parties involved, the treatment of preferential claims (e.g. by banks or tax authorities) and the stimulation of amicable out of court settlements. Bankruptcy policies should also address the stigma on failure which still prevails in some Member States and which interferes with a dynamic entrepreneurial culture<sup>14</sup>.

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<sup>13</sup> Report from the Commission to the Council and the European Parliament – The State of the Internal Market for Services of July 30, 2002 (doc. nr COM(2002) 441 final)

<sup>14</sup> See also "Bankruptcy and a fresh start: stigma on failure and legal consequences of bankruptcy"  
[http://europa.eu.int/comm/enterprise/entrepreneurship/support\\_measures/failure\\_bankruptcy/bankruptcy.htm](http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/failure_bankruptcy/bankruptcy.htm)

### **3. Capital market reforms**

In order to promote **capital market** integration, further progress at the EU level, notably with respect to the implementation of the Financial Services Action Plan and the Risk Capital Action Plan, is key. Determined implementation should lead to an effective integrated European market for financial services. Progress has been made in the reorganisation of market supervision, but the task is far from complete. Increased consolidation in the financial services market in most Member States clearly demonstrates the need for completing an EU wide market for financial services, also with a view to improving effective competition.

Capital markets, like labour and product markets, have a critical role to play in achieving the Lisbon objectives. The Commission Report *Quantification of the Macroeconomic Impact of Integration of EU Financial Markets*<sup>15</sup>, published at the end of 2002, suggested that full integration of the Union's capital markets would add around €130 billion to GDP in the steady state and, of itself, increase employment by around ½ per cent.

Consolidation in the financial sector has progressed further in most Member States. In some Member States this might eventually harm competition in this sector. Therefore rapid completion of the single market for financial services is crucial. The Financial Services Action Plan (FSAP) is central to this endeavour. It would be wrong to underestimate the progress that has been made. 31 of the 42 measures contained in the FSAP have reached completion, including adoption or agreement of the eight measures identified as priorities by the Barcelona Council. Nevertheless, a significant task still lies ahead to reach a state of full adoption.

More importantly, however, benefits are not derived just from agreeing a piece of paper, however important. The key is to ensure that the Action Plan is implemented speedily and energetically, requiring not only that legislation, where needed, is effected quickly but also that adequate resources are given to enforcement. The new Lamfalussy arrangements offer significant help in these respects and it is important that they are exploited to the full.

The guiding principle must be that the potential gains from an integrated and fully competitive financial market are realised. A general theme of this Annual Report is relevant here, namely that the benefits to consumers are uppermost in the implementation. This suggests that decisions about implementation should be made as transparently as possible, and with a conscious aim to consult and involve consumers in the decision making process, to the maximum extent practicable.

The ready availability of venture capital, especially at the early stages of enterprise, has a clear role to play in the Union's quest to become the most dynamic economy in the world. As the figures 2a and 2b display, some progress has been made in increasing both early stage and overall venture capital in Europe, notwithstanding the dip after 2000 probably associated with cyclical factors. Nevertheless, availability of venture capital in even the best performing European countries remains below that in the United States.

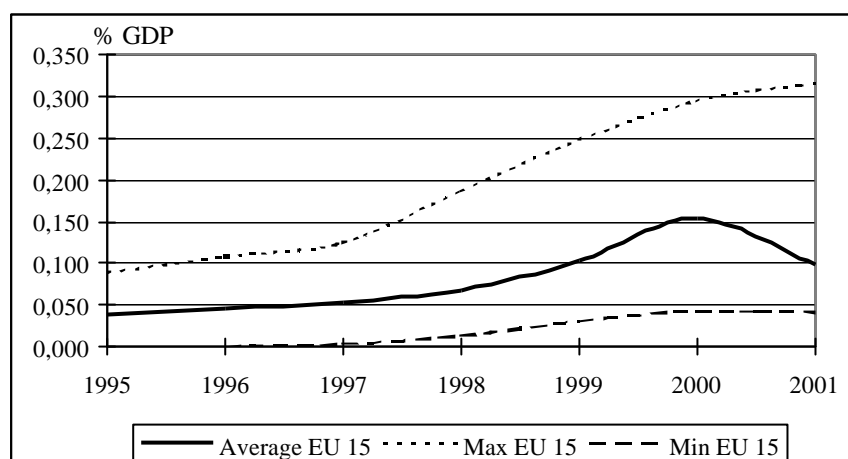
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<sup>15</sup> [http://www.europa.eu.int/comm/internal\\_market/en/finances/mobil/overview.htm](http://www.europa.eu.int/comm/internal_market/en/finances/mobil/overview.htm)



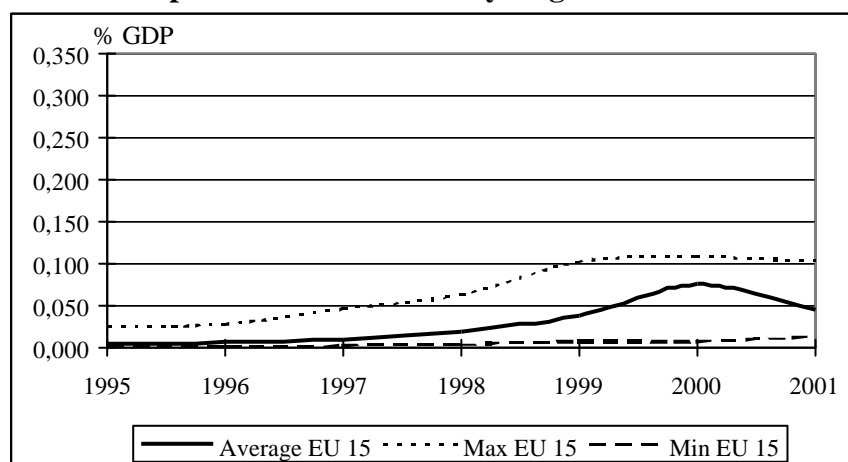
The Risk Capital Action Plan (RCAP) has an important role to play in ensuring both that venture capital is available in increased volume, across the EU, and, moreover, that it is available at competitive rates. It therefore needs to be fully implemented, respecting the deadline of the end of this year. This is necessary as part of a broader approach to create an economic environment favourable to enterprise, if the gap with the United States is to be closed.

**Figure 2a – Venture capital investments – expansion and replacement**



Source: EU structural indicators, Eurostat

**Figure 2b – Venture capital investments – early stage**



Source: EU structural indicators, Eurostat

#### **4. Knowledge-based economy**

As regards the **knowledge-based economy**, priorities should be to create conditions for investments in business R&D and to promote university/business links. Member States and in particular the business sector need to make further progress towards the Barcelona aim of 3% of GDP expenditure on R&D and innovation, two thirds of which is to come from the private sector. An efficient education system is of central importance for achieving permanently higher productivity growth and to provide a supply of appropriately skilled workers. The number of science graduates should increase to meet demand. While offering personal development opportunities, educational systems should

be focused on quality outcomes and be more closely attuned to labour market needs. The creation of a business friendly Community patent, is urgently needed to improve incentives to invest in R&D. There needs to be provision of a robust intellectual property regime. Reforms in labour, product and capital can contribute to foster the knowledge-based economy. Greater competition product markets is needed to stimulate innovation by removing the scope for complacency and inefficiency and increasing the pressure on firms to innovate. As are reforms to provide more accessible low-cost capital markets.

The EPC's report to ECOFIN, a year ago, *Report on Research and Development*<sup>16</sup> showed the clear and strong linkages between Research and Development (R&D) and productivity growth. Given the direct linkage of the latter to the Lisbon objectives, the importance of strengthened R&D performance is self-evident. But the EU's R&D performance remains persistently below that of the United States.

The aim to move towards 3 per cent of GDP, with two thirds of this in the private sector, set by the Barcelona Council is currently met only by Sweden and Finland (see figure 3). For the EU as a whole, the target is unlikely to be reached without significantly more effort. The structural indicators also suggest that the problem is particularly associated with business R&D, where the proportion of total spending in Europe is much lower than in the United States. The Commission's *European Innovation Scoreboard* for 2002 confirms that business sector R&D in Europe has continued to grow more slowly than in the US. The individual company might not reap the full benefit of its R&D spending and hence, the level of aggregate R&D might be sub-optimal, providing an argument for introducing measures to increase business R&D spending. However, it should be borne in mind that increasing R&D spending only makes sense if the outcome of such spending is an overall productivity boost. Hence, when introducing measures to increase R&D spending, cost-effectiveness of such measures is of utmost importance.

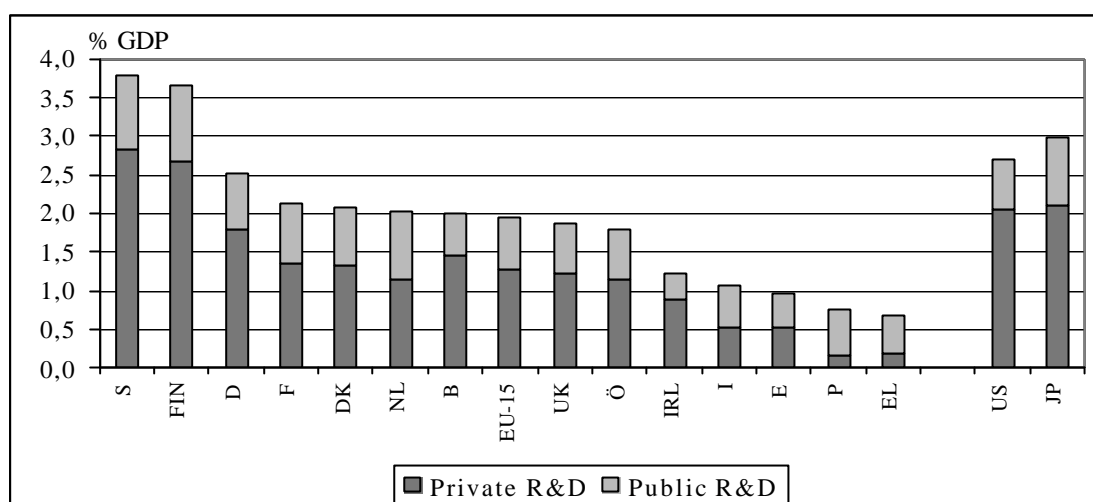
It is paradoxical – the “European Paradox” – that this relatively weak performance occurs despite a strong science and knowledge base. For this reason, attention needs to be given to improving the linkages between universities and other research centres, on the one hand, and businesses, on the other. Such measures need to include giving universities the freedoms and incentives to exploit their research findings, if appropriate in partnership with commercial counterparts. More generally, Member States need to ensure there are robust mechanisms for ensuring knowledge transfer between the research and academic communities and the business sector. Disseminating research as well as completing it is an essential ingredient.

As shown repeatedly by the EPC and academic studies, structural reforms in labour, capital and product markets improve the framework conditions for fostering R&D and innovation and may therefore be highly conducive to higher investment in R&D and can foster innovation.

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<sup>16</sup> [http://www.europa.eu.int/comm/economy\\_finance/epc/documents/rdfinal\\_en.pdf](http://www.europa.eu.int/comm/economy_finance/epc/documents/rdfinal_en.pdf)

**Figure 3 – R&D expenditure**



Source: 2002 European Innovation Scoreboard (SEC2002) 1349, December 9, 2002

The EPC report also identified that R&D should not be considered in isolation. Successful outcomes depend on establishing the framework conditions that R&D requires. One of the most important of these is ensuring a workforce equipped with the skills that a modern dynamic economy requires. The issue is not just one of inputs. Spending on education for Europe as a whole remains at about the same percentage of GDP as in the United States. Rather the task is to ensure that the education and training financed in this way endows the workforce with the skills that the European economy needs.

A related framework condition identified by the EPC report is the provision of a robust intellectual property regime. Businesses will be deterred from investing in R&D or other forms of innovative activity if they are unable to secure a proper return from their investment. Current patent arrangements in the EU are expensive and cumbersome. European Patent Office procedures are five times more expensive and take twice as long as the equivalent ones in the US. Enforcement has to be carried out separately in each Member State. Reform in this area, leading both to the provision of a Community patent with a single unified jurisdiction, and being obtainable under more efficient and streamlined procedures, is therefore important and urgent.

Fundamental to the R&D and innovation process is high levels of international competition. Widely identified as a likely key driver of innovation, higher product market competition removes the scope for complacency and inefficiency and increases the pressure on firms to innovate. This means both improving competitive disciplines across the economy, and working on those particular markets where competitive pressures are weakest.

## **5. Environmental policy**

Member States are taking steps to ensure **appropriate protection of the environment**. Such actions should be based on a thorough analysis of costs and benefits. Some countries are making increasing use of market based instruments to ensure that environmental objectives are reached in a cost efficient manner and with minimum distortionary effects. These examples should be copied more widely.

The national Cardiff reports also provided information on environmental objectives and policies. This included the impact of environmental regulations on product market functioning and the use of market-based instruments, also in relation to the objectives of the EU sustainable development strategy agreed by the Gothenburg European Council in June 2001. In this respect it showed from the national Cardiff reports, i.a. that achieving the Kyoto targets on CO<sub>2</sub> emissions is a central goal in Member States' national sustainable development strategies. In this respect the Council decisions to tax the use of energy and to introduce a system of tradable emissions rights were cheered.

Actions to ensure appropriate protection of the environment should be based on a thorough analysis of costs and benefits and must take the effects on the international competitiveness of enterprises into consideration.

Some Member States reported increased use of market-based instruments, the application of the polluter pays principle and the greening of the tax system. It was notable, however, that although most intended and implemented policies are heading in the right direction, the objectives and the achieved results were not specified in most cases. This complicates the assessment of environmental policies. Sometimes friction arises between environmental objectives and free circulation of goods. One example was found in Denmark, where the ban on canned beer and soft drinks has recently been lifted. However competition in this market is still limited which could be partly due to the existence of a monopoly in the collection of empty cans.

## **6. Public sector efficiency**

<p>The <b>public sector</b> accounts for a large share of the Union's economy, as well as providing the infrastructure for the rest of the economy. This makes efficiency in this sector particularly important. This should be achieved inter alia by increased cost-awareness by the use of outsourcing, increasing freedom of choice and by incalculating business-like financial management and accounting. Attention also needs to be given to dismantling barriers to open public procurement, critically assessing the use of all state aid, and the promotion of e-government. While maintaining budgetary discipline, productive public investment should proceed at rates necessary to underpin longer-term economic growth.</p>
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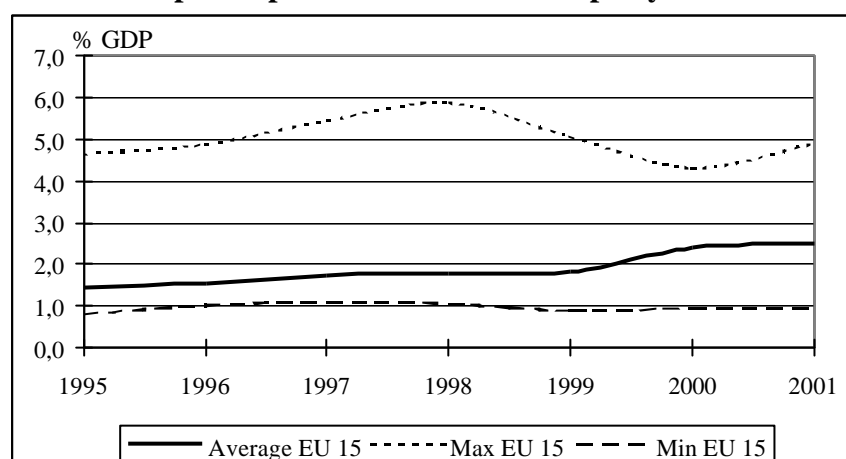
The public sector has a seminal role in relation to the Lisbon objectives: directly, because it accounts for around a fifth or so of the total economy; and indirectly because it provides much of the environment and the infrastructure within which the rest of the economy has to operate. An efficient public sector is therefore a *sine qua non*. This is quite apart from the imperative for governments to provide citizens with high quality public services within what can be afforded. Achieving efficiency needs a multi-faceted approach but the country examinations highlighted some priorities.

First, there is wide agreement as to the benefits of public procurement, which accounts for about a sixth of total EU GDP, being conducted openly. The benefits of open and competitive procurement, for citizens and taxpayers, as well as businesses, are self-evident. In the Netherlands a parliamentary inquiry committee found considerable fraud in the construction sector. A lack of competition due to insufficient use of openly advertised public procurement alongside improved possibilities for collusion among potential

suppliers appeared to be at the heart of this problem. While progress has been made in raising the proportion of public procurement conducted in this way, it has been disappointingly slow. As the structural indicator makes clear, advertised public procurement has levelled out at about 2 ½ per cent of GDP, implying that only about 16 per cent of procurement is conducted in this way. Intensified effort is therefore required.

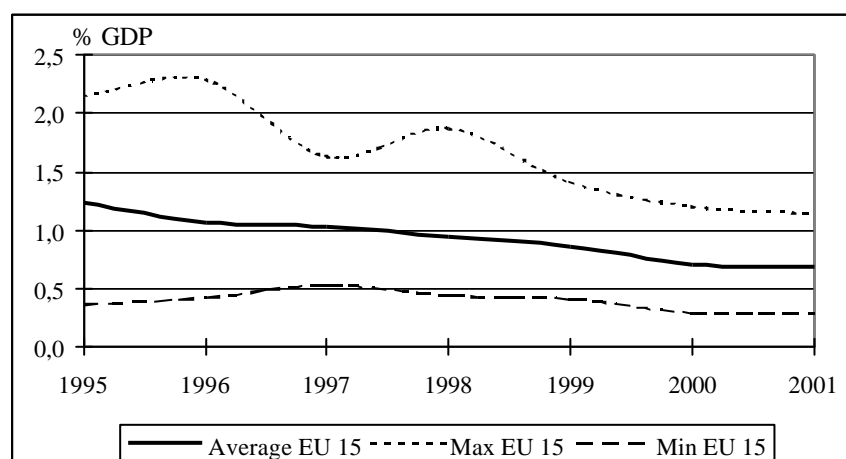
The two directives within Council, on which political agreement has been reached - relating respectively to supplies, services and work contracts, and to rules for utilities procurement - represent an important way forward. Early adoption will provide benefits. But as always, timely and energetic implementation is of the essence.

**Figure 4 – Value of public procurement which is openly advertised**



Source: EU structural indicators, Eurostat

**Figure 5 – Sectoral and ad hoc state aids**



Source: EU structural indicators, Eurostat

Secondly, the progress towards a modernised state aid needs to be accelerated and will pay high dividends in terms of overall welfare. As the structural indicator shows, state aids have been falling in relation to GDP and shifting away from sectoral and ad-hoc aid – often the most harmful to competition. Building upon this requires three developments. One is to intensify pressure on state aids that undermine competition (especially the most distortive aids). The second is to target state aid towards horizontal objectives, address clearly identified market failures and to increase efficiency. The third is to streamline the

state aid procedures, focusing attention on aid that is economically significant, and dealing much more quickly and simply with aid that is not significant. These considerations will become even more important in the context of the enlarged Union.

Thirdly, government and the public sector need to benefit from technological advance no less than the rest of the economy. More rapid and more even progress in adapting the ICT revolution to the needs of government is particularly relevant for boosting productivity in the public sector. E-government has the potential not only to allow more efficient communication but also to offer the opportunity for radical redesign of the way that government interrelates with and provides services to its citizens. However, the country examinations pointed to a yet unexploited potential.

Finally, the public sector's role in providing the infrastructure for the economy overall implies the importance of ensuring that public spending pays proper regard to the need to maintain, renew and extend the infrastructure. However, as always, it is productive outputs rather than the expenditure itself that is important. Accordingly, governments would be well advised to ensure that investment is productive and well targeted. The value of targeting investment and avoiding non-productive expenditures becomes all the greater in circumstances of fiscal stringency. The use of cost benefit analysis across the Union is patchy and in many cases, investment in greater capability to carry out such analysis would itself pay high dividends.

## **PART II**

### **COUNTRY NOTES**

## **Belgium**

### ***General assessment***

Economic growth in Belgium broadly corresponds to the average EU performance and inflation remains well within the 2 percent limit. Belgian productivity levels are the second highest in the EU. Although continued structural reforms have been supportive to this, it also reflects in part the relatively low labour market participation. Particularly worrisome are the relatively large regional disparities, which exist within this relatively small country.

The Belgian economy is well integrated in the EU. Relative price levels are close to the EU average and value of imports and exports (as % GDP) for goods and services rank among the highest in the EU. However some doubts exist on the progress made in the effective liberalisation of network industries. The opening-up of the electricity market has not yet brought Belgian electricity prices down to the EU average. This might be at least partly due to the still dominant position of the largest electricity generator, which has a market share of around 90%. Furthermore effective supervision could be enhanced by a close co-operation between the federal and the regional supervisors. In railways effective competition has been absent so far.

Belgian labour market participation levels fall short in all segments as identified in Lisbon and Stockholm. Also employment growth has been relatively modest in comparison to the EU average and regional disparities seem rather persistent. Further raising participation levels is of particular importance in relation to addressing the financial challenges related to the ageing of the population. In this respect the Belgian government took several measures to raise the participation level of older workers. These measures focus on prevention (training, improving working conditions) and activation (right of outplacement for workers over the age of 45 who are laid-off). However, the “time credit system” may have a negative impact on labour supply and employment and should therefore be closely monitored.

On the knowledge-based economy further emphasis should be put on life long learning while on public R&D Belgium is falling behind the EU average.

### ***Main achievements***

The main achievements of Belgium have been found in the following area:

- The corporate tax reform will come into force in 2003. Tax rates will be lowered to levels comparable to other EU Member States and the tax base will be broadened. Also important steps have been taken in simplifying administrative procedures, inter alia by modernising the trade register, creating a one stop shop for enterprises and promoting e-government.

### ***Challenges***

In order to keep track with the Lisbon strategy, Belgium needs to:

- raise employment levels is the biggest challenge for Belgium. Further measures could be envisaged in the field of reducing non-wage labour costs and promoting, in collaboration with the social partners, wage negotiations that are more in line with sectoral and local differences in productivity. Close assessment of the active and preventive measures with the aim to raising participation of older workers is deemed necessary. Should they not produce the desired results sufficiently fast, than the government should stand ready to take further action.
- improve the functioning of network industries by increasing market transparency and by better involving consumers in the liberalisation process.



## **Denmark**

### ***General assessment***

Denmark has made substantial progress in contributing to the EU wide Lisbon targets. This strategy has clearly paid off and added to an enviable performance regarding economic growth, productivity and labour market participation. Economic growth has been slightly below the EU average since 1998. Danish productivity growth is fairly strong, and labour market participation is among the highest in the EU.

On product market functioning there is evidence that competition is less keen than in other Member States. The relative price level of private consumption (excluding indirect taxes) is 4 percent above the EU average and has only gradually decreased over the past ten years. The value of exports and imports of goods (as a percentage of GDP) is relatively low and has only slowly increased in the past decade. The electricity market is formally opened to competition as from 2003. Currently, consumers are only able to choose their preferred supplier for 60 percent of their electricity consumption. Although steps have been taken to fully liberalise the gas market as from 2004, a *de facto* monopoly is still operating in this sector.

The capital market is performing well. On the whole the financial services sector seems in good shape and is clearly awaiting the completion of a pan-EU financial services market. Labour market participation is the highest in the EU. This strong performance is due to a combination of relatively loose employment protection legislation, effective active labour market policies and tight eligibility criteria for social benefits. At the moment there is some risk of overheating and wage-push inflation. If the Danish economy would pick up, e.g. due to better prospects for the world economy, the labour supply restriction might become binding. Therefore Danish policies aim at raising employment rates among older workers and immigrants as well as to increase pass-through of young people in education. Further scope for improvement is found in the transformation to the knowledge-based economy, notably on the efficiency of expenditure on education, which is one of the highest in the EU. Danish R&D spending amounts in 2001 to 2.4 per cent of GDP, having increased steadily since the mid-1990. Especially rising business sector R&D has contributed to this.

### ***Main achievements***

The main achievements of Denmark have been found in the following area:

- Early retirement schemes have been reformed by tightening eligibility criteria and by rewarding return to work for disabled. As a consequence of the reform, replacement rates have come down and the employment rate of older persons has increased markedly.

### ***Challenges***

In order to keep track with the Lisbon strategy, Denmark needs to:

- develop a more proactive approach to opening up markets, e.g. in the field of energy, housing, books and cans. This will benefit Danish consumers and is conducive to a more innovation-prone climate.
- continue the modernisation of the public sector and allow private businesses to enter the market for public services with the aim to strengthen the individual citizen's opportunity to choose. Also special emphasis should be put on improving the efficiency of spending on education.
- beyond the Lisbon agenda, Denmark needs to increase its labour supply to ensure long-term sustainability of public finances and hence, safe guarding future welfare.

## **Germany**

### ***General assessment***

GDP growth has been weak in Germany over the last two years, mainly due to a sharp fall in domestic consumption and investment, aggravated by the international downturn. While the budget deficit has crossed the threshold of 3% of GDP, with a non-negligible risk of exceeding that limit again in 2003, price developments remain subdued.

Germany is marred by a high level of unemployment, also characterised by important regional disparities. While unemployment among the youth is low, long-term unemployment is of special concern. Both the total employment rates and that of older workers, nevertheless, are around the EU average, while female employment is clearly above. Some actions have been taken to address possible labour supply problems, while on the other hand the recent adjustment in social security contributions may hamper an increase in labour demand.

While Association Agreements have developed reasonable qualitative access conditions for the electricity sector, the level and the broad regional divergence of access fees for the medium and low voltage network are still a matter of concern. This issue is currently addressed by abuse control procedures of the competition authorities as well as by monitoring of access fees within the framework of the Association Agreements.

Regarding the gas sector, Germany has not yet implemented the main gas directive and has therefore been brought up before the European Court of Justice by the European Commission.

### ***Achievements***

In 2002, Germany has launched several important reforms:

- The Hartz Commission has designed a series of reforms to improve the functioning of the labour market: in particular improvements to the employment services, increased possibilities for companies to “test” recruits from temporary agencies before hiring them on infinite-term contracts, reinforcement of the coherence between social and unemployment benefits, promotion of life-long learning. The reform package took effect in early 2003; first results are expected around mid-2003 and further elements are expected to take effect from 2004 onwards.
- In conjunction with the social system’s overhaul, some measures are being envisaged to make the health services more efficient.
- A second pillar has been developed for the pension system, although it has not met the expected success yet.
- The powers of competition authorities are to be reinforced.
- Four successive financial acts should reinforce the financial markets’ integration and transparency.

### ***Challenges***

In order to keep track with the Lisbon Strategy Germany should:

- devote special attention to lowering on social contributions. Acting on labour demand should require first priority, while tackling the supply side (increasing the incentives to work for older workers and long-term unemployed, offering women more childcare facilities to help them to participate to the labour market).
- closely monitor the impact of the current reforms against the sought after objectives; be ready to accelerate or deepen them when needed.
- further promote wage moderation in the competitive manufacturing sector.

## **Greece**

### ***General assessment***

Greece has made a tremendous effort in catching up with the EU 15. Growth figures have been well above the EU average since the mid 1990s and the Greek economy even continued to perform well in 2001 and 2002 whereas most other Member States suffered from the global economic slowdown. In spite of this impressive progress the Greek GDP per capita (in PPS) is still only two thirds of the EU average. The reforms, which have been implemented by the Greek government, are of the right kind but they have to be intensified and speeded up if Greek economy is to level with the EU average in time for achieving the strategic Lisbon goal. Further reforms should be geared to improving both participation and productivity, which is currently at circa 85 percent of the EU average.

On the product markets Greece was the last Member State to liberalise its telecommunications industry. In the energy sector draft legislation has been prepared in anticipation of the Council decision to accelerate the liberalisation of gas and electricity sectors in November 2002.

In the labour markets improvements have been found in taxation and education. Nevertheless Greece is still far from reaching the Lisbon and Stockholm participation targets. Moreover employment has barely increased since the mid 1990s, whereas most other Member States have shown clear improvements. It should be underlined though that these aggregate figures conceal a sectoral shift in employment out of the agricultural sector and into the manufacturing industry. Increasing participation levels is also required with a view to financing pension requirements, which are projected to be one of the highest in the EU. It appeared that older workers have anticipated (potential) reforms of the early retirement scheme and withdrew from the labour markets using existing regulations.

Further attention is also required for developing the knowledge-based economy as Greece is still performing relatively poor on most related structural indicators, including spending on human resources, private R&D and the availability of venture capital.

### ***Main achievements***

The main achievements of Greece have been found in the following areas:

- Important steps have been taken to improve the legal and regulatory framework for SMEs, including a reduction in administrative barriers, the promotion of e-commerce and improving access to finance.
- Greece reported progress in the field of life long learning, for instance by establishing so-called second chance schools. A tax credit to stimulate private R&D has been introduced recently.
- State aid has been reduced to 0.6 percent (EU: 0.7 percent) and redirected to horizontal objectives.

### ***Challenges***

In order to keep track with the Lisbon strategy, Greece needs to:

- improve productivity. Scope for improvements has been found in a broad range of areas, including enhancing competition and promoting education and training.
- pursue rigorously the planned tax reforms with a view to reducing the tax burden.
- relax very strict employment protection legislation regulations. Although Greece argued that *de facto* employment protection legislation was less strict, it would be an important step forward to formalise this relaxation.

## **Spain**

### ***General assessment***

Following four years of buoyant growth at or above 4 percent per year, economic growth in Spain has tempered in 2001 and 2002, although the economy is still performing well above the EU average, continuing the process of real convergence with the EU.

Product market functioning is clearly improving. The trade integration of the Spanish economy in the EU is advancing at a steady pace, the amount of state aid has been substantially reduced and increased use is made of openly advertised public procurement. In 2002 the Spanish reforms on product markets focussed on improving competition, deepening of the liberalisation of network industries and reducing the administrative burden. Parliament is currently debating the New Enterprise Project, which should lead to a simplification of administrative procedures for businesses. Capital market reforms aim at limiting public involvement in savings banks and improving the auditing system and the financial conditions of SMEs. In Spain labour market reforms in the past have been successful in creating employment. Since 1996 the employment rate has increased with ten percentage points to 58 percent, notably as a result of the vast increase in female participation under 35. Following the high priority given to the improvement of the labour market functioning, further reforms have been introduced in 2002. In the field of the knowledge-based economy priority is given to public R&D spending and raising private involvement through the improvement of the fiscal and regulatory framework.

### ***Main achievements***

The main achievements of Spain have been found in the following areas:

- In 2002, new labour market reforms have been approved in the unemployment benefits system, aiming at raising participation (especially of those most prone to risk of long-term unemployment), promoting active job search, increasing labour mobility and improving the process of supply-demand matching. Measures have also been adopted to promote active ageing and to remove incentives to early retirement, mainly by setting up a phased and flexible retirement system.
- Measures have been taken to strengthen competition policy, including institutional reinforcement of the competition authorities, enlarge their financial, human and technical resources and improve the transparency and publicity of their activities. The review of the bankruptcy law will further add to a sound business climate.
- Liberalisation of network industries has progressed: competition in telecommunications has been reinforced and energy markets (both electricity and gas) has been fully liberalised on 1 January 2003.
- Some measures, mainly in the tax system, have been implemented to improve the functioning of the housing market, like the reduced taxation of rental income.

### ***Challenges***

In order to keep track with the Lisbon strategy, Spain needs to:

- focus on increasing wage differentiation in line with regional and sectoral differences. Together with the social partners the government should look for ways to improve the wage bargaining institutions. The measures taken to discourage early retirement will require close monitoring.
- pursue further efforts in raising its productivity. Productivity development has been rather low, which partly reflects the rise in employment. However clear scope for improvement has been found in raising competition (e.g. retail sector) and in developing the knowledge-based economy (spending on human resources, venture capital, ICT expenditure, R&D spending).

## **France**

### ***General assessment***

After exceptional years in 1997-2000, France has been undergoing a slower pace of growth in the last two years. Tax reductions implemented in expansion years seem not to have been properly backed by expenses reduction. Now close to the 3% deficit limit, France no longer enjoys comfortable margins for the implementation of reforms. Quick action is however necessary to re-ignite growth dynamics and overcome emerging challenges, such as population ageing.

While job creation has been particularly buoyant in recent years, France is still quite far from the targets defined in Lisbon and Stockholm for the total employment rate and particularly for older workers (at 63% and 32% respectively).

The product markets seem to function quite satisfactorily, although certain competition problems remain (e.g. housing market, large retailers to some extent retain a monopsony power over their suppliers).

Obstacles to the creation of new businesses remain high: the existence of different procedures with social and fiscal services hamper the set up of a one-stop shop. The transmission regime of small companies also deters the involvement of relatives, which entails a loss in experience and human capital. The impact of the newly decided measures could remain insufficient in this respect.

The implementation of environmental directives probably wants more commitment to the goals pursued. The proportion of electricity derived from renewable sources decreased in 2000, as few efforts have been made to meet the target agreed for France at Göteborg of 21%.

### ***Achievements***

Over the past year France's main achievements took place in the following areas:

- France has reviewed its tax and benefit system in order to promote low-skilled workers' participation in the labour market. Among other dispositions, a special tax credit has been installed. While the design is good, the amounts implied make it probably still insufficient to have an impact on low-skilled workers' incentives to join the official labour market.
- With the new Act promulgated on 3 January, France is on the way to completing its legal framework for the liberalisation of the electricity and gas market. Full implementation of the 3 January Act is however pending on the adoption of necessary decrees.

### ***Challenges***

In order to keep track with the Lisbon strategy, France needs to:

- increase labour market participation among the low-skilled workers and the aged workers. For this purpose, France is committed to reform of its pension system by mid-year, notably with a view to increasing incentives to stay longer in employment.
- make sure that the electricity and gas markets are effectively open to competition by the agreed deadlines, despite their vertical integration.
- speed up the implementation of EU directives on environmental protection.

## **Ireland**

### ***General assessment***

From exceptional levels, growth has gone down in the last two years to levels closer to (but still higher than) the EU average. Inflation remains high however, and this reflects high labour costs in a number of sectors and limited competition in certain services sectors.

Despite the global slowdown, Ireland's results on the labour market are still impressive: its employment rates are high, even among older workers, and employment growth is above the EU average. The gap between male and female employment has narrowed, with female employment about the EU average.

Along with employment, labour productivity has greatly improved in the last years and is above the EU average.

R&D expenditures are still below the EU average, most of the efforts being probably attributable to foreign investment. However, the Government has been seeking to address this through the multi-annual National Development Plan.

Ireland's energy markets are characterised by the predominant market shares of the incumbent firms and a low level of electricity interconnections, despite Ireland's recent efforts.

### ***Achievements***

In 2002, Ireland has implemented a certain number of reforms:

- Several measures have been taken to facilitate the combination of activity and family life for women, thereby contributing to their retention in the labour force.
- On the products market, the Competition Authority has been reinforced. Other efforts have been made to enhance competition on the energy market, and in certain sectors such as pharmacies, liquor incensing and insurance. A few measures have been envisaged to foster competition in transports.

### ***Challenges***

In order to keep track towards the Lisbon objectives, Ireland should:

- find a balance between its proactive wage policy and the budgetary constraints.
- strive to foster competition in sectors such as professional services, retail distribution and insurance.
- ensure that competition is effective in network industries.

## **Italy**

### ***General assessment***

Italy is on a path of slow recovery after having followed the international downturn. Despite the unfavourable environment, the government has embarked on a policy of simultaneous tax and deficit reduction, largely funded through one-shot measures. Whether this course will remain sustainable in 2003 without significant expenses cuts, is doubtful.

Italy has a lot of progress to accomplish on the path towards a knowledge-based society. It has so far achieved low levels of R&D, and its workforce is still insufficiently trained to take up the ICT society's challenges. The size of Italian companies – which are mainly SMEs – cannot account for the totality of these insufficiencies.

This is however on the labour market that Italy has the greatest efforts to achieve. In spite of the remarkable employment growth of the last few years, the Italian employment rate still ranks last in the EU (55.4%). Italy's labour market is apparently marred by an important structural unemployment, with considerable regional differences (unemployment is around 4% of the active population in the North, about 18% in the *Mezzogiorno*).

### ***Achievements***

Many projects have been submitted to Parliament in 2002, in all fields covered by the 2002 BEPGs:

- On the labour market, the Pact of Italy presents a series of measures which should ease employment protection and increase the incentives for low-skilled workers to take up a job. The Finance Bills for 2003 have reinforced the possibility to combine seniority pensions and employment incomes, offered by the 2002 Finance Bill and so far hardly used.
- A reform of the education system is still under review in Parliament. Several recent measures are geared towards the development of innovation.

### ***Challenges***

In order to progress towards the Lisbon objectives, Italy now needs

- to continue its efforts towards increasing labour market participation. Since employment clearly presents regional patterns, encouraging social partners to allow for wage differentiation at the regional level could also be helpful.
- complete the reform in the energy sector - where the effects of liberalisation on prices have not been tangible - and increase competition in professional services and local public services.
- pursue its efforts to enhance the education system's effectiveness, reinforce training opportunities, and foster business involvement in R&D.

## **Luxembourg**

### ***General assessment***

GDP rose by 1% in 2001, 0,5% in 2002, against an average of 6% per year between 1985 and 2000. As a consequence, the unemployment rate has started to rise in 2002 (2,6%), remaining nevertheless the most favourable in the EU. Despite strong growth in total employment (+5,5% in 2001 and 2002), the employment rate of older workers is particularly weak, placing Luxembourg at the second lowest rank of the EU.

Although the government detains about 40% of the GDP in financial assets, a reform of the pension system appears necessary to guarantee its sustainability.

Regulation in the Luxembourg economy is still fairly high, notably for prices, wages and the labour market. Such regulation seems to have been consistent to a certain extent: the cap on prices allowed for the containment of the inflation increase to 2,1% in 2002, despite the automatic indexation of wages on prices. On the other hand, the potentially harmful effects of these rigidities have partly been compensated by competition from neighbouring markets. Following repeated recommendations however, this regime should be abolished with the long awaited enactment of the bill on competition.

The financial sector, very developed in Luxembourg, has declined in the last three years, due to the economic slowdown but also to competition from other places. Certain fields, such as venture capital, are virtually absent from private banks activities, and the sector could suffer at a later stage from its specialisation.

### ***Achievements***

In 2002, Luxembourg launched many reforms, the effects of which are still pending:

- On product markets, a competition bill is being currently discussed, which should install a Competition Council. A new regime on state aid is in preparation. The administrative burden on companies has been further eased. Many initiatives have been taken to foster entrepreneurship and the culture associated.
- Regarding the knowledge-based society, progress has continued on the implementation of the e-Luxembourg programme.
- Attempts have been made to render the labour market more flexible. Some improvement has been observed regarding female employment. Social security laws passed in June might nevertheless increase the general cost of labour.

### ***Challenges***

In order to fulfil the Lisbon objectives, Luxembourg should now:

- increase labour market participation, especially among women and aged workers, and undertake reform of the pension system.
- ensure that competition is effectively ensured in services (professional services, housing, internet charges, etc.).



## **Netherlands**

### ***General assessment***

The resilience of the Dutch economy has proved rather disappointing so far. Although the Netherlands already started working on a comprehensive structural reform process in the early 1980s, the recent slowdown underlines the need and scope for further reforms. Since mid 2001 quarterly growth has been fluctuating around the zero-mark and annual growth figures have fallen behind the EU average. Being a small open economy it is not surprising that the Netherlands is relatively hard hit by the global slowdown and the ongoing appreciation of the euro against the dollar. However a key determinant of the Dutch slowdown is the development in unit labour costs, which have surpassed the EU average by more than 2 percentage points annually since 1999. This strongly eroded price competitiveness of Dutch producers in comparison to their competitors inside and outside the eurozone.

On product markets the Netherlands takes a middle position in the EU when it comes to carrying through liberalisations in network industries. Measures have been taken to reform services sectors like childcare, taxis and notaries. In most cases the desired results have however not yet fully materialised. Continuous monitoring remains necessary.

Although the labour market has performed outstandingly in the past years when it comes to employment creation and raising participation rates, some persistent problems remain. In particular the well-known disability problem, which seems to hide a large labour reserve, the poverty trap and the relatively low number of hours worked per person employed.

More effort should be put in developing the knowledge-based economy, notably at the knowledge base: education, S&E students. Also diffusion of knowledge inter alia by promoting business-university links is important.

### ***Achievements***

The main achievements of the Netherlands have been found in the following areas:

- The Netherlands seriously addressed some market regulations, which may impair competition in services sectors like childcare, notaries and taxis. Also the Netherlands is well on track in liberalising network industries.
- Strong performance of the labour market has resulted in a substantial increase in participation rates, especially for women, which rose from 51% in 1991 to 65% in 2001.

### ***Challenges***

In order to keep track with the Lisbon strategy, the Netherlands needs to:

- give priority to improving the productivity growth. In its progress report the Netherlands makes the correct analysis on the impediments to productivity growth. It now comes to taking swift action, notably by improving the knowledge base, raising competition in the services sector and fostering the business climate.
- pursue further labour market reforms, if the Dutch labour market is to continue its good performance. The new government should now give priority to the long awaited reforms of the disability scheme and addressing the poverty trap. A further decentralisation of the wage negotiations may promote the prospects for increased wage differentiation in line with productivity differentials.

## **Austria**

### ***General assessment***

Austria has recorded growth rates in the average of the EU in the recent years, as its good performance eroded in line with international developments. It still has a remarkable unemployment rate, the third best in the EU behind Luxembourg (which has a weaker employment rate) and the Netherlands (whose good performance heavily relies on a disability scheme and part-time work). This good result is partly attributable to high wage flexibility. It should not, however, hide Austria's poor record in employing older workers, especially among women. This is the main field where Austria should make significant effort to meet the Lisbon target.

When installed, the new government is expected to broadly pursue the liberalisation of the economy. The openness of the electricity and gas markets is legally in force.

Environmental awareness is quite high, and Göteborg's target for renewable energy is already largely met. Austria's tax rate on diesel is relatively low in comparison to the EU average, but is above the harmonised minimum tax rate on diesel.

### ***Achievements***

In 2002, Austria has made significant progress in certain fields:

- The creation of a new competition authority is welcome, as well as the possibility for it to file a suit before the Court of Cartels independently from the attorney general. For the moment however, the means devoted to this authority are notably insufficient to guarantee its efficiency.
- A train of measures aimed at facilitating the creation of businesses has been set in place end 2002. It provides for the installation of one-stop shops for companies, the easing of bankruptcy laws, the promotion of e-registering, the federation of the merger of the main business and financial support institutions, etc.

### ***Challenges***

In order to keep track with the Lisbon strategy, Austria should:

- tackle the issue of early retirement within the broader framework of a comprehensive pension reform.
- pursue its efforts for the liberalisation of the economy, promoting wider opening hours, granting the Competition Authority with sufficient resources to make it effective.
- closely monitor price developments on the energy market.
- continue to promote business R&D while strictly assessing the effectiveness of each implemented scheme.

## **Portugal**

### ***General assessment***

After quite dynamic years, growth has slowed down from 1999 due to a falling domestic demand. Insufficient consolidation of expenses in the upward phase of the cycle has prompted important imbalances during the downturn, both in the government budget and the external balance.

Portugal enjoys one of the highest employment rates in the EU. This is also true when looking at older workers, since Portugal has the third highest effective retirement age. In 2001, employment growth in 2001 was the second highest in the EU. High wage flexibility partly accounts for these good results.

On the flip side of the coin, Portugal still has the lowest labour productivity in the EU both per person employed and per hour. A spontaneous attitude of “labour deepening” might account for it, but insufficient educational attainments and training could be further explanations. With 0,75% of its GDP devoted to R&D, mostly from government sources, Portugal is also lagging far behind the EU average.

Portugal has taken a slow course in the liberalisation of networks industries, especially regarding the telecommunication sector. Energy prices are still above the EU average, especially for domestic users.

### ***Achievements***

In 2002, Portugal has implemented some structural reforms:

- Productivity and growth programmes concentrate on reinforcing competition, fostering entrepreneurship, R&D and investment. Previous Competition Authorities have merged, but the Competition Law has reduced some the new Authority’s powers while increasing its scope of investigation.
- A new labour code should be adopted by April. It should increase flexibility in labour contracts, notably by reducing job demarcation and firing costs and raising regional and intra-firm mobility. Management overtime should become more flexible and the scrutiny period reduced.
- The Portuguese stock exchange has merged with Euronext, thereby increasing the potential market for Portuguese company bonds. The full benefits of this move could probably be reached if Portugal joins the common settlement system, euroclear.

### ***Challenges***

In order to keep on track for the Lisbon strategy, Portugal should:

- pursue the current policies designed to foster entrepreneurship, innovation and investment.
- continue its specific efforts aimed at meeting the knowledge-based society requirements, namely on education and R&D.
- pay particular attention to competition issues, especially in the energy sector.

## **Finland**

### ***General assessment***

Finland suffered from a marked economic slowdown in 2001 but it seems to have regained its way up. The relatively solid basis of Finland with respect to achieving the strategic Lisbon goal will have contributed to this projected recovery. Finland is generally considered one of the most competitive countries in the world (EIU, WEF). In this respect it is remarkable that although the Finnish productivity performance in terms of the total factor productivity has been relatively good in 1990s, productivity per person employed is still only slightly above EU-average and productivity per hour worked falls short of the EU average.

Some doubts have been raised on product market functioning. The relatively high price level, the non-compliance of the competition authorities with some EU regulations as well as the value of openly advertised public procurement, which is slightly under the EU average, added to this assumption. On the other hand the high price level partly reflects high indirect taxes, the remoteness of the country and low population density. The OECD noted that there are no practical problems for the competition authorities to perform its duties in line with the Treaty and apart from taxis and pharmaceuticals there are no legal obstacles to competition. Finally it appears that much publicly procured goods and services do not surpass the threshold and thus do not appear in statistics. On balance the legal conditions for a sound competitive environment, also for network industries, are broadly in place. The Finnish overall employment rate (68%) is approaching the Lisbon target of 70 percent. However the labour market is characterised by two striking features: high structural unemployment rate and the low employment rate of older persons. High structural unemployment is explained by *inter alia* high unemployment among the low skilled, low geographical mobility and severe long-term unemployment among certain individuals, especially in the eastern and northern regions of the country. For older workers it has been relatively easy to withdraw from the labour market, either through early retirement schemes or through the unemployment and disability benefit systems. The Finnish transition to a knowledge-based economy is well advanced. With the exception of level of internet access and ICT expenditure, Finland ranks among the top three of best performers on all other structural indicators in the field of innovation and research.

### ***Main achievements***

The main achievements of Finland have been found in the following areas:

- Strengthening economic fundamentals and facilitating the diffusion of ICT.
- The greening of the tax systems has been continued by reducing income taxes and increasing energy taxation.
- Several initiatives have been started, including the introduction of vouchers, extensive benchmarking and the promotion of e-government. Furthermore a change in the incentive structure for financing municipalities has been announced.

### ***Challenges***

In order to keep track with the Lisbon strategy, Finland needs to:

- give priority to reducing structural unemployment. Also the measures taken to discourage early retirement should be closely monitored to see whether they provide the desired results sufficiently fast. Further reforms might be needed.
- continue the modernisation of the public sector, *inter alia* by increased participation of the private sector and competition between public service operators.
- improve the contestability of markets, notably in the retail and other services sector, housing, also with a view to raising productivity.

## **Sweden**

### ***General assessment***

Sweden is performing very well in almost all dimensions and fields of the Lisbon strategy. High labour market participation has largely contributed to Sweden's above EU average growth figures since the mid 1990s. However a well above EU average price level points to yet unexploited benefits in opening markets and improving competition. This will also increase productivity levels, which is currently one of the few weak spots in the Swedish economy. On the functioning of product markets the barriers to competition in a number of sectors are notable. These barriers were reported in both the tradable (pharmaceuticals) as well as non tradable (housing, retail trade) goods and services. Although the government expressed a clear wish to limit competition in retail trade of pharmaceuticals for reasons of public health it should nevertheless be aware of the effects in the form of reduced access. Also the local governments' role in providing semi-public services, risks creating an unlevel playing field. Sweden was also one of the frontrunners in liberalising its network industries, which led to broadly satisfying results on price developments and consumer choice. Nevertheless the relatively large price gap for energy between industrial users and consumers requires further attention by the competition authorities.

Sweden is one of the only three Member States attaining all employment goals set in Lisbon and Stockholm. A wage formation process that has been capable of taking into account both price stability and productivity developments as well as effective active labour market policies have contributed to this. However Sweden set itself an even more ambitious target to raise the employment rate in non-subsidised jobs to 80% in 2004, thereby specifically focussing on policies for young people and immigrants. Of particular concern is the high number of people drawing on disability benefits. Apart from the ageing of the workforce a number of other developments seem to be contributing, like increased stress in the workplace and ineffective rehabilitation, relatively loose administrative procedures and a tightening of eligibility criteria for early retirement schemes. The Swedish transition to a knowledge-based economy is well advanced. However, policies should focus on how the high investments in education and R&D can translate into higher productivity. The use of market-based instruments in environmental policy is significant.

### ***Main achievements***

The main achievements of Sweden have been found in the following areas:

- Good progress has been made in reforming tax- and benefit systems with a view to promoting both work incentives and entrepreneurship.
- The efficiency of active labour market policies has been improved by better targeting them at those most prone to long-term unemployment.
- Strengthening competition legislation with respect to combating cartels.

### ***Challenges***

In order to keep track with the Lisbon strategy, Sweden needs to:

- strengthening framework conditions for competition, including for public service provision at local level, is key with a view to improving productivity levels.
- ensure an adequate labour supply over the medium term.
- reduce the number of people drawing on disability benefits. The self-imposed objective to halve the number of people drawing on disability benefits in 2008 (compared to 2002) will require intensified action in collaboration with the social partners.

## **United Kingdom**

### ***General assessment***

The UK economy has performed relatively well over the past years. Annual GDP growth exceeded the EU average while inflation has been the lowest in the EU 15. However, although the UK economy is well integrated in the EU and open to international competition, its price level remains well above the EU average. Some evidence prevails that insufficient competition in a number of key sectors, notably in services, has contributed to this. Furthermore a higher than EU average increase in unit labour costs partly due to low productivity increases are thought to have contributed as well. On the other hand the UK is one of the frontrunners in liberalising network industries. As a result the incumbent's market share in the electricity and telecommunications industry has substantially decreased over the years. This provided benefits to consumers, as network prices are now amongst the lowest in the EU.

The capital market is generally performing well and conducive to business creation and growth. This is largely due to a well-developed market for venture capital. As in most other Member States both supply and demand have plummeted following the economic downturn. Some concern exists on the level of competition in retail banking.

The UK is only one out of three Member States, which already attains the Lisbon and Stockholm targets for labour participation. Although this illustrates the good overall performance of the UK labour market, it must be added that persistently wide regional disparities exist. Also a relatively large gender pay gap is found.

### ***Main achievements***

The main achievements of the UK have been found in the following areas:

- The revision of the Enterprise Act is thought to contribute to a further strengthening of competition. Important elements in this new Act encompass the full independence of competition authorities, a proactive role to keep markets under review, a new regime for market investigations and the possibility to impose criminal sanctions on those engaging in hard core cartels.
- Continued efforts have been taken to enhance the quality of public services, notably by setting Public Service Agreements, which link funding to performance targets.
- Encouraging first steps have been taken to put the notorious railway sector back on track. However it is stressed that these are only first steps; close monitoring is needed.

### ***Challenges***

In order to keep track with the Lisbon strategy, the UK needs to:

- give priority to targeting the historic weaknesses in the key drivers of productivity performance, including the further strengthening of competition, promoting entrepreneurship, supporting science and innovation, improving skills through better education for young people and encouraging investment to improve the stock of physical capital.
- address the low participation and employment rates of older workers and consider reforming disability and sickness schemes.
- continue addressing labour market problems in deprived areas.

## **PART III**

### **SPECIAL SUBJECT: EARLY RETIREMENT<sup>17</sup>**

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<sup>17</sup> The Economic Policy Committee wishes to thank the Commission services for extensive contributions to this chapter.

## **Special subject: early retirement**

This year special emphasis has been put on policies to **raise the average effective retirement age** in the EPC country examinations. Regrettably, the progress towards the target set in Stockholm for increasing the average EU employment rate among older women and men (55-64) to 50 percent by 2010 is very limited and unlikely to be reached at the current rate of progress. In addition, while the average effective retirement age has risen slightly, it is still far from the Barcelona objective of an increase of about 5 years. Although all Member States have taken measures aimed at promoting labour market participation of older workers, it is still doubtful whether these policies will be sufficient to reach the Stockholm target. Therefore in some Member States further measures are necessary to reach the targets. Scope for further improvement is to be found in moving unduly favourable pension systems towards actuarial neutrality, and in tightening up early retirement schemes, - both reducing replacement rates and tightening eligibility rules, notably for unemployment and disability schemes that often lead to early retirement. Achieving the Stockholm target for participation of older workers will also critically depend on the progress made in further reforming labour, product and capital markets. In view of the budgetary pressures the Union faces, it is essential that measures to limit early retirement and to promote active ageing are cost effective.

Early retirement has been selected a special topics in the 5<sup>th</sup> annual country review undertaken by the Economic Policy Committee in 2003<sup>18</sup>. To provide a comprehensive description of the incentive/disincentive to work facing older workers, in this note we consider as legal or “de facto” early retirement schemes all those schemes that allow an older person to receive a benefit without working (or have an obligation to active job-search), until he/she reaches the statutory retirement age.

Obviously, every scheme that provides pension benefits for older persons who are under the standard old-age retirement age should be viewed as an early retirement scheme. In addition, an alternative pathway into retirement is often permitted by programmes related to unemployment and disability conditions. Older workers can use these programmes to bridge the time until they can receive regular old-age pensions. On the other hand, if an old-age retirement scheme envisages a flexible retirement age with appropriate actuarial reductions in the benefit level, the scheme should not be regarded as an early retirement scheme. One can identify different schemes, which are relevant to Member States such as early old-age pension (“dedicated” early retirement schemes), disability-conditional pension/benefit schemes, unemployment-conditional (extended benefit) pension schemes (including those provisions exempting individuals from job-search), part-time pension schemes and other early retirement schemes, including old-age pensions granted to specific groups (occupations) at an age below the common retirement age, or occupational schemes with early retirement provisions.

This note summarises all the relevant information made available by Member States on the institutional aspects<sup>19</sup> that give rise to supply-side financial disincentives to continue working as faced by older workers. It does not address issues related to the demand side for older workers, which is the other relevant part of the problem of low employment rates

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<sup>18</sup> The policy issues were discussed in the Note for the Economic and Financial Committee and the Economic policy Committee on “Reducing Early Retirement” (*ECFIN/324/02-en*, June 2002).

<sup>19</sup> The description is necessarily simplified and cannot capture the full complexity of individual country early retirement systems. For a detailed description of the existing early-retirement schemes, see annex 1 to the Cardiff Reports prepared by Member States at the end of 2002. A more comprehensive description of the overall pension system can be found in the National Strategy Reports on Pensions.



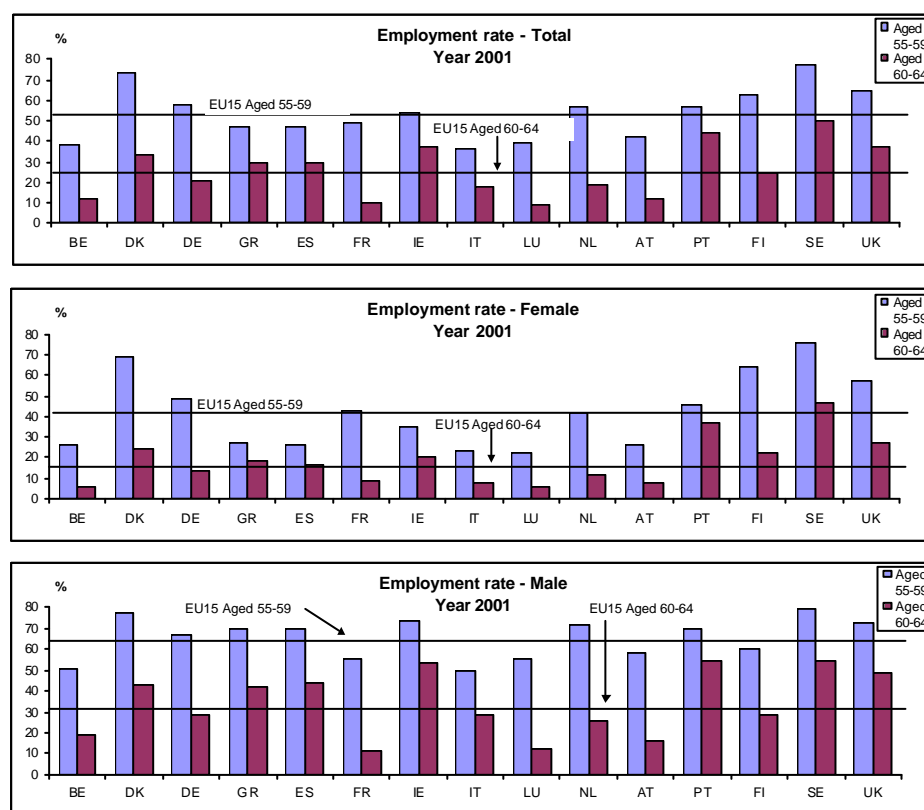
for older workers in some Member States. In providing a description of the existing early retirement schemes, the aim of the paper is also to make a contribution to a better understanding of how recent reforms could have affected the incentives to work for older persons, and consequently of the driving forces behind the current and future trends in labour-force participation of older workers.

### **Employment and participation rates of older workers: some figures**

The political objective of reducing recourse to early retirement was laid down at the Stockholm European Council. EU Member States set a target for increasing the average EU employment rate for older men and women (aged 55-64) to 50% by 2010.

In 2001, the employment rate for older workers was 38.6 per cent in the EU, compared to 58 per cent in the US. Furthermore, the employment rate for older workers has risen only by less than 3 percentage points in seven years (from 35.7% in 1994). This pace is clearly not enough to achieve the employment rate target of the Stockholm. In 2001, employment rates for older workers were particularly low in Belgium (26.5%), Luxembourg (26.7%), Italy (28.0%), Austria (28.6%) and France (31.0%). Sweden (66.5%) and Denmark (58.0%) recorded the highest employment rates for older workers, and, along with the UK and Portugal, are the only four countries that already met the Stockholm EU-wide employment target for workers aged 55-64. As can be seen in Figure 6 and table 3, work and participation drop off after the age 60 and the vast majority of people in this age group is not working in almost all Member States. This situation clearly shows that older workers are a major reserve of labour in virtually all EU countries.

**Figure 6 - National employment rates**



Source: EU structural indicators, Eurostat

The low rate of employment of older workers denotes a clear under-utilisation of the labour force and is one of the major factors that has contributed to the lower growth rates of the GDP per capita during the last decade (1.7% p.a. in the EU and 2.3% p.a. in the US). Policies aimed at increasing the employment rates of older workers can have various positive effects. Increasing the time spent in employment and reducing the time spent in retirement, should also contribute to strengthening the financial sustainability of pension systems and, more generally, to economic growth and welfare. Thus, reforms of early and pre-retirement pension schemes are particularly important and should focus on improving the incentives to work and reducing the take-up of non-actuarial early pensions. Furthermore, if the average age of exit is not increased in line with increased life expectancy, i.e. keeping the average numbers of years in retirement relatively constant as a proportion of years in employment, the sustainability of pension systems risk being undermined. Furthermore, this will lead pension systems where the age of exit is not taken into account when calculating the annual pension income to be increasingly generous.

**Table 3 - Development in national participation rates**

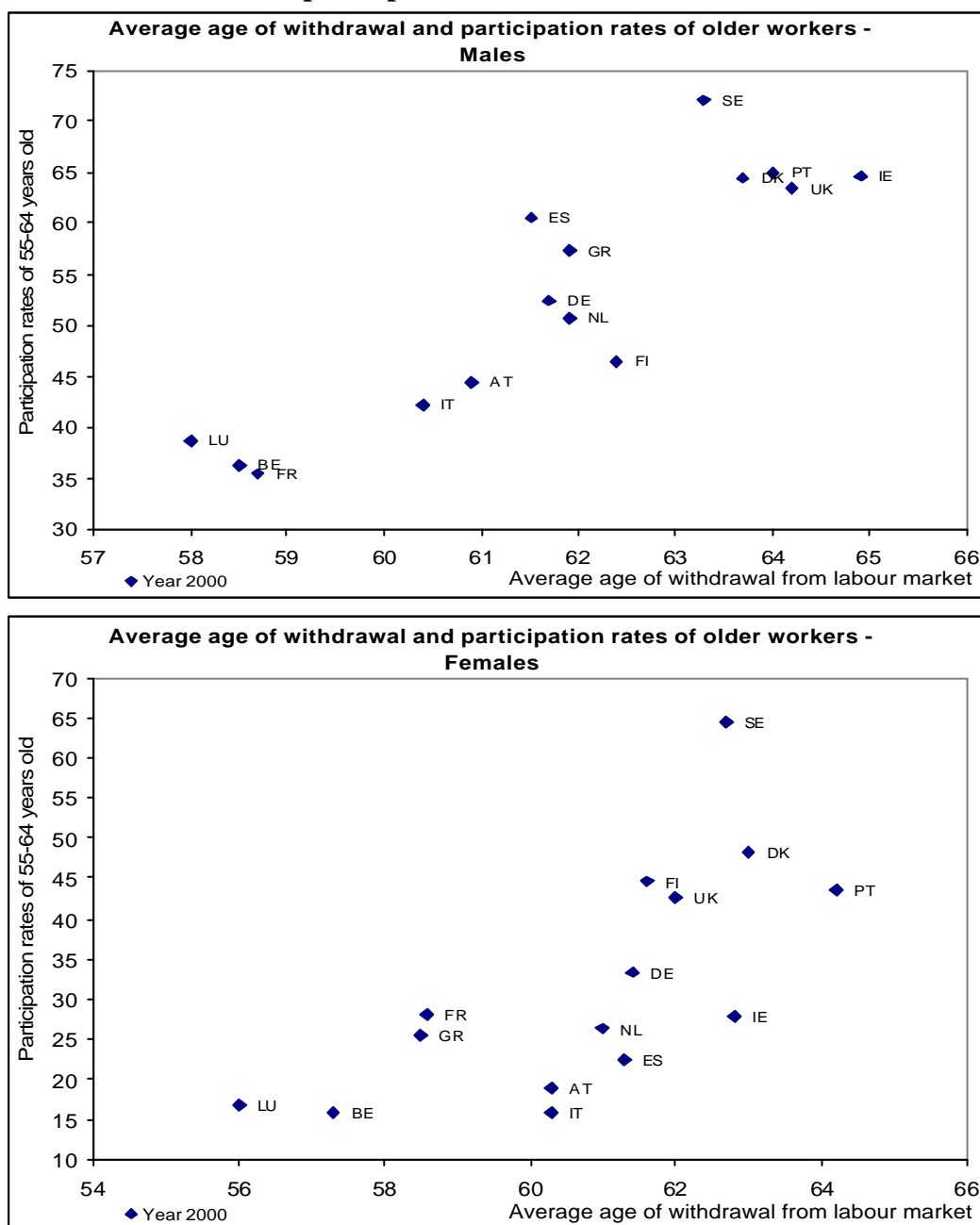
		Participation rates					
		Males			Females		
		1990	1995	2001	1990	1995	2001
BE	55-59	50.2	53.2	52.6	15.7	21.5	26.2
	60-64	19.3	18.6	19.8	4	5.4	5.4
DK	55-59	86.3	83.1	81.5	63.1	57.6	72.9
	60-64	51.2	50.8	43.8	28.3	21.6	24.5
DE	55-59	80	72.6	76.8	43	47.2	56.8
	60-64	34.6	28.7	31.2	12.3	10.4	14.3
GR	55-59	72.3	74.8	73.1	28.5	28.9	29
	60-64	46	47.4	43.2	19.9	20.2	19.2
ES	55-59	76.2	71.3	74.3	23.6	24.9	28.4
	60-64	46.8	39.7	46.1	15.3	15.1	17.3
FR	55-59	60.4	60.2	59.4	40.8	44.9	46
	60-64	16.4	11.2	11	12.4	10.4	9.6
IE	55-59	77.8	73	75.9	23.7	26.3	36.2
	60-64	54.7	56.1	54.6	14.4	15.2	20.8
IT	55-59	67.7	57.4	52.3	19.7	19.8	24.3
	60-64	34.8	29.9	30.3	10.1	7.8	8.1
LU	55-59	63.1	53.8	55.6	18.1	18.3	22.7
	60-64	23.1	14.8	12.3	9.5	8.2	5.6
NL	55-59	66.1	60.1	72.6	24.6	28.6	42.5
	60-64	22.8	20.3	25.9	8.7	7.9	11.9
AT	55-59	:	62.9	62.1	:	27.6	27.9
	60-64	:	20	16.7	:	9.8	8.3
PT	55-59	75	70.4	71.3	38.5	42.1	46.6
	60-64	55.2	52.6	56.2	24	25.9	37.3
FI	55-59	:	58.2	67.7	:	56.2	70.6
	60-64	:	21.7	30.2	:	17.9	23.8
SE	55-59	:	85.7	82.9	:	79	79
	60-64	:	56.8	57.9	:	47.5	48.7
UK	55-59	81.6	73.7	75.5	54.8	55.8	58.2
	60-64	54.5	50.1	51.1	22.8	25	27.5
EU15	55-59	:	67.8	68.9	:	39.8	45.3
	60-64	:	32.3	33.7	:	14.1	16.1

Source: EU structural indicators, Eurostat

At the Barcelona European Council in March 2002, EU Member States agreed to reduce early retirement incentives for individuals and the introduction of early retirement schemes by companies with a view to achieving a progressive increase of about 5 years in the effective retirement age by 2010. Some countries had already taken steps to increase the statutory retirement age or, at least, to rise the retirement age of women to that of men

(or that in the public sector to the higher retirement age in the private sector)<sup>20</sup>. In most EU countries, the general statutory retirement age is now 65 years (in France it is still 60 and in Denmark 67-to be reduced to 65 from 2004). In Italy a flexible retirement age of between 57-65 with full actuarial adjustment was introduced in 1995 but the new system only applies to new workers and to those with less than 18 years of paid contributions in 1995.

**Figure 7 - Withdrawal and participation rates of older workers**



Yet, in general the effective retirement age, i.e., the age at which people retire de facto, has not kept pace with the rate of increase in life expectancy. As a result, over the past decades, people have been in receipt of pension for an increasingly long period of time.

<sup>20</sup> But the legal retirement age in the public sector is still 55 years in Greece (although there has been a gradual increase in the age limit) and 60 years in Portugal and the UK.

Currently, there is wide disparity in the average age of withdrawal from labour market across Member States, ranging from about 58 (in L, B, F) to more than 64 (in IRL, UK) years for males, and 56 (L) to 64.2 (P) for females. There are different reasons for early withdrawal from the labour market and individuals have alternative pathways to retirement, through schemes other than the old-age scheme, such as early retirement, pre-retirement, disability pension schemes, or special schemes linked to dismissal or redundancy. Besides these pathways, one should also consider that part of older unemployed are de-facto in a state of early-retirement, because they are not really looking for a job, and for them it is on average more difficult than for younger person to get a job offer.

The wide variation in the average age of withdrawal across Member States is clearly reflected in employment and participation rate of those aged 55-64 years, as Figure 7 clearly shows. For example, in the five Member States (B, F, I, L, Ö) with the lowest age of withdrawals from labour market, more than half of the working-age population aged 55-64 was not participating in the labour force in 2001, with extremely low rates in Belgium (36.6%), and Luxembourg (35.5%).

### **Indicators of incentives for early retirement: pension wealth and replacement rates**

Many factors continue to lead to withdrawals from the labour market, mainly incentives embedded in old-age pension schemes and other income support programmes. The age of retirement is influenced by the interaction of all these factors, such as the accrual rates, the pension replacement rate, contribution rates, age of entitlement to old-age or special retirement schemes, all of which contribute to the overall design of social security systems.

The OECD<sup>21</sup> provided calculations of replacement rates and (after-tax) pension wealth<sup>22</sup> for 6 Member States for 2001 (figures are not available for B, DK, E, EL, IRL, L, Ös, P, S). These two indicators point to the existence of different incentives to work or retire for different groups. Pension wealth is calculated as the present value of all the future stream of pensions that one person is entitled to receive at a given moment, net of the present value of all future contributions to the pension system. In an actuarially neutral system, the pension that would have been received, net of the cost of paid contributions for the additional year of work, should be equivalent to the increase of the future stream of pension (which depends on the accrual rate). If this were not the case, an additional year of work would result in a negative change in pension wealth. This represents an “implicit marginal tax” on working an additional year. As can be seen from table 4, this is the case for France and the Netherlands, while for Germany the system appears to be fairly neutral or even provides a positive change in pension wealth if the pre-retirement is postponed. But individuals can have an incentive to retire earlier even when facing positive or neutral dynamics of pension wealth for additional working years. This is so if the replacement rate is high enough to ensure an adequate living standard in retirement. This is the case in the Netherlands (due to the VUT early-retirement schemes), France and Germany.

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<sup>21</sup> See OECD, “Policy responses to the challenges of ageing populations: a synthesis”, DEELSA/ELSA/WP1 (2002) 3.

<sup>22</sup> The calculation is limited to the hypothetical case of an individual unmarried, who will reach the normal retirement age after 40 years of work, and is based on parameters already in force in 2001 or, as the case for Italy, that will hold when legislated reforms will enter into force.

**Table 4 - Replacement rates and changes in pension wealth (after tax) as per cent of earnings: regular old-age retirement schemes in some Member States- 2001**

	Earning as % of APW wage	Earliest age of benefit	Average replacement rate in early retirement	CHANGES IN NET PENSION WEALTH			
				Pre-retirement period (average, from earliest age to "normal" age )	At "normal" retirement age	From "normal" retirement age to age 68 (average)	From "normal" retirement age to age 70 (average)
Finland	50%	60	81	-60	-86	-85	-85
	100%		59	-18	-69	-70	-69
	150%		57	-1	-70	-70	-69
France	50%	60	95	-94	-94	-94	-94
	100%		87	-86	-86	-86	-86
	150%		79	-78	-78	-78	-78
Germany	50%	63	78	0	-7	-19	-27
	100%		71	0	-6	-17	-24
	150%		76	0	-7	-18	-26
Italy	50%	57	70	-27	0	0	0
	100%		67	-21	0	0	0
	150%		67	-22	0	0	0
Netherlands	50%	60	84	-83	0	0	0
	100%		83	-82	0	0	0
	150%		84	-84	0	0	0
United Kingdom	50%	65	53	-	-53	-53	-53
	100%		40	-	-40	-40	-40
	150%		33	-	-33	-33	-33
United States	50%	62	60	41	9	0	-12
	100%		47	24	-5	-11	-14
	150%		43	17	1	-4	-8

Source: OECD

### **Recent reforms**

Old-age pension systems can be made more employment-friendly by introducing modifications allowing for greater actuarial fairness, such as increased more flexibility regarding retirement age and rewarding additional time in employment. Appropriate reforms aimed at combining flexibility regarding the retirement age and actuarial neutrality would allow people to choose, at least to some extent, their retirement age and to adjust the pension level in a way that is actuarially neutral. Those that decide to retire earlier, would do so at the cost of a permanently lower pension, while for those that retire later, the reward would be a permanently higher pension. An increasing number of countries have started to provide older workers with some flexibility in deciding their age of retirement, with pension rights reflecting, in a more or less actuarially fair way,

individual choice. This is, in particular, the case for Sweden and Italy<sup>23</sup> (but only for those enrolled in the new system) with the shift to notional defined-contribution scheme in the public pension system, the Netherlands with the new flexible pension schemes, and in the future for Finland, where a flexible retirement age between 62 and 68 has been recently finalised and will be introduced in 2005 and Spain with its new flexible retirement system which allows workers to continue working later than 65 (statutory retirement age), with higher pensions when claimed after 65 and exemption from social security contributions. Other countries, such as Austria, Finland, Germany, Portugal, Spain, have introduced (or increased) cuts in the amount of pension (more or less actuarially based) for early retirement.

Some Member States allow people to be eligible for pension before the standard retirement age on the basis of a combination of two criteria: a minimum number of years of paid contributions, and a minimum age. This is still the case of Italy, where the eligibility rule for an early (seniority) pension, i.e. setting a lower age limit (57 years) to supplement the requirement of an adequate number of contribution years, has been tightened: for private sector employees this year and public sector employees in 2004. This reform will be fully phased-in only in 2008, when the number of contribution years will be raised to 40 (currently 35). This means that these amendments have not yet affected existing incentives to retire early. In 2002, Greece has introduced similar rules based on different combinations of a minimum number of years of paid contributions, and a minimum age.

A number of Member States (Belgium, Finland, Germany, Luxembourg, Spain, Austria and the Netherlands) have promoted part-time working of older workers as a way to allow a gradual transition to retirement. This measure seems to act more as an alternative to complete early-retirement rather than a way to prolong working after the legal retirement age, suggesting that these part-time pension schemes are too generous (in Spain partial retirement covers two cases: workers under 65 (early retirement) and over 65. In the first case, working hours and wages in the part-time contract are reduced by 25-85%. In the second case, pension is reduced by a percentage inversely equivalent to the proportion by which working hours are fewer than those worked by a full-time employee).

In some countries (Belgium, the Netherlands, the UK), early retirement is also possible under occupational pensions negotiated between employers and employees<sup>24</sup>. It is difficult to provide a comprehensive account of all the provisions of these schemes, given that they differ across sectors and professions. One relevant issue concerning these schemes is that they have often been used by firms as early retirement schemes, without reductions in pension benefits, in case of restructuring or downsizing so as to render these processes more socially acceptable. In the Netherlands there are tax incentives for transforming existing schemes in new, more flexible but actuarially neutral, occupational schemes.

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<sup>23</sup> Italian pension reforms introduced a contribution-based method in the pension system. However, the new contribution-defined system is to be fully applied only to those entering labour markets from 1996 onwards. Those already in the labour market at the end of 1995 but with less than 18 years of contributions will be subject to transitional arrangements.

<sup>24</sup> In five countries, (Belgium, Denmark, Ireland, Sweden, and United Kingdom), the second pillar occupational schemes are, at least partially, based on a defined-contribution system.

Work beyond the standard retirement age is often subject to restrictions. In some countries pension benefits received after the standard retirement age are means tested, and this implies that there is a clear disincentive to defer withdrawal from work imbedded in the system; the extent of the disincentives is also affected by the level of the earning disregard (when receiving both pension and income from work) and the withdrawal rates. Recently, Germany (after 65 years), Finland (63 years), France, Spain (after 65), Greece (after 67) have increased accrual rates or introduced a bonus for people prolonging their work activity. Recently, measures aiming at extending active employment were adopted in Spain in order to allow older individuals to work while receiving a pension. This is also allowed, within certain limits, in Italy (the Budget Law for 2003 extends the scope for combining seniority pensions and employment incomes). Continued reform to increase employment among older workers is needed in most member states. Therefore, when reforming pension systems the objective of ensuring sustainable public finances should be taken into account. Hence, policy measures should be cost effective.

In some countries, persons enrolled in different kinds of benefit schemes related to inactivity, such as disability, early retirement and unemployment, can accumulate their old-age pension rights (sometimes at a lower rate) even if they are not working.

Through a loosening of the conditions for access to the scheme, disability schemes have often been used to cope with redundancies and collective dismissal of older workers. In some countries, the benefit level in disability schemes is relatively high and also higher than in unemployment or early retirement schemes, while the eligibility criteria are rather generous or their enforcement lax (especially in area or during period characterised by labour market problems). In 1999, Sweden, Portugal, Germany and Austria were among the EU countries with above-average inflows of older persons (55-64) into disability schemes.<sup>25</sup> In the UK, the majority of inactive individuals aged between 50 and the state pension age are claimants of the “Incapacity benefit”<sup>26</sup>. Another well-known case is the Netherlands, where 38% of the 1 million persons (4% of the labour force) receiving a disability benefit in 2001 are in the age group 55-64 years. The Dutch government plans an overhaul of the disability scheme to reduce the inflow of new people claiming disability.

Unemployment programmes (through a combination of unemployment benefits, unemployment assistance, unemployment pensions and social assistance) provide a “bridge” until the time of receipt of old-age pensions is reached in Belgium, France, Germany, Finland, the Netherlands (in Spain unemployment benefit for workers over 52 provides that kind of “assistance”: unemployed over 52 can perceive the benefit until statutory retirement age, under certain conditions. Law 45/2002, reforming unemployment benefit schemes has made eligibility conditions more restrictive since unemployed are obliged to undertake an activity commitment and it strengthens the means-testing (and also in Italy, for some categories of workers made redundant after restructuring of firms with more than 15 employees in the industrial sector-the so-called “*long mobility scheme*”). Older workers are allowed to stay on prolonged unemployment benefits (or unemployment pension) without a formal or actual job-search requirement. Entitlement conditions have recently been made more restrictive in some Member States. In 2002,

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<sup>25</sup> See OECD “Transforming disability into Ability. Policies to promote work and income security for disabled people” 2002.

<sup>26</sup> Around 75 per cent of those between 50 and the state pension age (65 for men and 60 for women) on benefit are on an incapacity benefit. See the report by the UK Department for Work and Pension “Pathways to work: helping people into employment”, page 8, 2002.

Belgium reintroduced the job-search requirement for newly unemployed persons aged more than 56 (57 since July 2003) but nothing was done regarding the existing relevant stock of older unemployed already enrolled in the older scheme. Finland decided to gradually phase-out the unemployment pension scheme but the prolonged unemployment benefit (the so-called “unemployment pipeline”) remains in place, although the minimum age for entitlement will be increased (from the current 55 to 57). In the Netherlands, the outgoing government had planned to eliminate the exemption from compulsory job-search for the older unemployed (over 57.5).

### **Main features of the schemes allowing older persons to be in a formal or “*de facto*” early retirement condition in the Member States<sup>27</sup>**

#### **Belgium**

Two main schemes: 1) fully unemployed people on benefit who are not job seekers (“older unemployed”); 2) the scheme under collective labour agreements.

1. **“Older unemployed” scheme:** exemption from availability to work for those over 50. Reformed on 1 July 2002: for new unemployed the exemption starts when older than 56 (57 since July 2003). The concept of “appropriate job” is adapted to the age-specific situation (Cf. Commuting time, etc). A complementary seniority allowance tops up unemployment benefit for “older unemployed” with at least 20 years of service.
2. **Early retirement under collective agreement:** (“*prévisions* conventionnelles”) unemployment schemes based on collective agreements (national, sector-based or company agreements). In case of lay-off, older workers can top up unemployment benefits with a complementary allowance paid by the employer or by a fund (at least half of the difference between the last month’s net wage (ceiling at €2,860.06) and the unemployment benefits (only concerns workers of the private sector). Regulations vary according to criteria such as age, seniority or company situation (specific system for ailing companies - two preceding negative financial years - and for restructuring companies - lay-off of 10% to 30% of the workforce).

#### **Denmark**

The statutory retirement age has been reduced from 67 to 65. The early retirement scheme was reformed in 1999 (former schemes still hold for those born before July 1939). The former unemployment-conditional scheme (“transitional allowance”) was closed for new entrants in 1996 and will be completely phased-out in 2006. Current main schemes: 1) “post-employment” scheme; 2) disability-conditional scheme (anticipatory pension); 3) partial retirement.

1. **“Post-employment” scheme:** for persons aged 60-64, with 25 years (over the last 30years) of paid contributions to unemployment and voluntary early-retirement schemes. Maximum pension is 91% of the highest flat-rate benefit (DKK 143.000 in 2002).
2. **Disability-conditional scheme (anticipatory pension):** for persons aged 18-65 with a working capacity less of 50%. Benefits are conditional on age and residual working capacity. Since January 2003 the benefit is equivalent to the maximum flat-rate benefit

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<sup>27</sup> Source: Member State’s Cardiff Report-2002, Implementation Report 2002, National Strategy Reports on Pension.



for single, and 85% of that for married/cohabitants. Eligibility criteria are made more restrictive.

3. **Partial retirement scheme:** weekly working time between 12-30 hours for those with paid contributions of at least 10 years over the last 20. Work performed in the early retirement period (60-64) results in an hour-by-hour reduction of the benefit. However, only a very limited number of persons make use of this scheme.

### Germany

Current four main schemes: 1) early retirement; 2) disability-conditional scheme; 3) unemployment-related scheme; 4) partial retirement.

1. **Early retirement scheme:** After the recent reform (2001), conditions for early retirement have been tightened. Eligibility from age 60 (5 years before the statutory age of 65) for women, employees born before 1951, unemployed persons, or people working part-time. Actuarial reduction is 0.6% per each month of early retirement.
2. **Disability-related scheme** (“*Erwerbsminderung-reduced earning capacity*”): Eligibility from age 60. The level of the pension (since 1<sup>st</sup> January 2001) is equivalent to an old-age pension for full disability to work, that is, when residual capacity to work is less than 3 hours a day, or if it is higher but there is no suitable (part-time) job offer. An actuarial reduction of 0.6 per each month of early retirement is applied up to age 63. Partial disability to work entitles the individual to only half of the old-age pension. The period of pension is limited to 3 years, but can be extended beyond this if the reduction in earnings capacity can not be overcome, and becomes unlimited after 9 years.
3. **Unemployment-related scheme:** unemployed persons aged 55 get unemployment benefit (with replacement rate of 60%) for 26 months (32 months for those aged 57). Afterwards they receive income-tested unemployment benefit (with a replacement rate of 53%) before moving on to the social assistance benefit. From age 60, they can get old-age pension, with an actuarial reduction of 0.6 per each month of early retirement.
4. **Partial retirement scheme:** based on voluntary collective agreements between social partners. Employees aged over 55 may work part-time and become eligible for a part-time pension that may amount to one-third, one-half or two-thirds of the full old-age pension. From age 60, they can retire and get the old-age pension, with an actuarial reduction of 0.6 per each month of early retirement.

### Greece

In June 2002 a major reform of public pensions was adopted in Greece (Law 3029/2002), and will be fully implemented by 2008. Employees with at least 37 years of contributions are eligible for pension without any age restriction.

1. **Early retirement:** Those insured after 1993, with 20 years of contributions will be entitled to receive a full pension at age 55 (instead of 65). The reduction rate for early retirement will be 4.5%, down from previous 6%. People can remain at work after 67 years in return for a higher pension benefit (3% per additional year).
2. **Disability pensions:** reforms introduced since 1990 have tightened the accessibility conditions. In 2000, the share of disability pensions in the total inflows to retirement was still 15% (although down from the peak of 30% in 1989).

### Spain

Current main schemes: 1) early retirement; 2) extended unemployment benefit for workers over 52; 3) benefit equivalent to early retirement; 4) disability-related scheme; 5) partial retirement; 6) early retirement for reason of the professional activity performed.

1. **Early retirement.** There are three cases. a) Workers enrolled in the state pension scheme before 1967: workers enrolled in the ‘Mutualidad Laboral de Trabajadores’ before January 1967 can retire from the age of 60. If the retirement is voluntary, a reduction of 8% per year (before 65) is applied. If retirement is not voluntary and the workers can accredit over thirty years’ effective payment of social contributions, the reduction is between 6-7.5% (according to the years of paid contributions). b) (since 2001) workers not paying contributions before January 1, 1967 may take early retirement as of sixty-one provided they have been made redundant for causes beyond their control, accrediting at least 30 years’ effective payment of social contributions and that they have been registered as available for work in the six preceding months. The pension reduction per year remaining to 65 will vary from 8 to 6% depending on the years of paid contributions. c) salaried workers whose employers replace them, on their retirement, by unemployed workers may retire at 64.
2. **Extended unemployment benefit for workers over fifty-two:** unemployed workers over 52 having paid unemployment insurance contributions for at least six years, claiming unemployment benefits can continue receiving it until statutory retirement age, provided they are unemployed, they have reached 52. Since 2001, unemployed, with at least 30 years of paid contributions may (it is no longer compulsory) retire at the age of 61. For each year before the statutory retirement age, pension benefits are reduced by 8-6% (according to the number of years of contributions).
3. **Benefits equivalent to early retirement** workers aged at least 60 years, who are dismissed because of, a reconversion process, may receive benefits equivalent to early retirement. The worker is deemed to remain enrolled in the corresponding social security regime and contributions are kept up in his/her name until statutory retirement age.
4. **Disability-related scheme:** applies to workers with a degree of disablement equal to or over 65%.
5. **Partial retirement:** two cases: a) with hand-over contracts, workers with full-time contracts may take partial retirement from 60, with the option of continuing beyond 65, with a part-time contract (with hours worked and salaries reduced). Simultaneously, employers enter into a hand-over contract with another worker, for a term equivalent to the time remaining for the first worker to reach statutory retirement age. b) flexible retirement: for workers over 65, since 2001 they are allowed to combine the receipt of a reduced pension with a part-time job.

### France

Four types of schemes have been implemented over the years, the most recent at the beginning of 2002. The biggest early retirement scheme however no longer admits new entrants (*Allocation de remplacement pour l’emploi*).

1. **Permanent unemployment scheme:** from 57 (or 55 if worker receives *Allocation de sécurité sociale* or if worker has already contributed 40 years to the pension system); applies until the worker acquires the right to retire with a full pension. This is the biggest scheme with 373,000 persons registered. Admission has decreased substantially.
2. **Early retirement** (first type of schemes): from 57 or 55 (no condition on the number of years of contributions). Replacement rate is 65% or 50% beyond a certain threshold. A total of approximately 105,000 persons are concerned. Admission in these schemes has greatly decreased in recent years.
3. **Early retirement** (new scheme): for those under 60 who no longer qualify for jobless benefits but have contributed 40 years to the pension system. Differential income

supplement of up to €877 per month. This scheme has been set up at the beginning of 2002.

4. **Partial retirement:** from 55 (no condition on contribution record); half-time employment. Replacement rate is 30% or 20% beyond a certain threshold. 44,000 persons are in this scheme.

### *Ireland*

The phenomenon of early retirement is less prevalent in Ireland than elsewhere in the EU. Looking at figures for men (taken from Eurostat figures published in 2001), the activity rate in the age group 55-69 is 55.9 %. This is the third highest in the EU and only marginally behind the highest values of Sweden at 57.3% and Portugal at 56.1%. When one considers that the Irish rate is more than twice the rate seen in France, Belgium and Luxembourg, the favourable situation is clear.

With regard to female participation in the age-cohort 55-69, Ireland ranks in the middle of Member States. However, this reflects a tradition of low participation rates of women in Ireland. This will change over time as younger cohorts, with much greater levels of attachment to the labour market replace older age groups in the demographic distribution.

Looking at the reasons for the lower rate of early retirement, social insurance pensions are not paid until the age of 65. In addition, the benefits paid are relatively less generous than elsewhere. Finally, the coverage of private pensions is lower in Ireland than elsewhere.

### *Italy*

Gradual shift from the old PAYG system to the new notional defined-contribution, which is actuarially neutral toward retirement age (flexible: 57-65). Two main schemes: 1) early-retirement (seniority scheme); 2) unemployment related ("long mobility")

1. **Early-retirement/Seniority pension:** in 2002 is possible for workers either 1) aged 57 and with at least 35 years of paid contributions or 2) with at least 37 years of paid contributions. This last condition will increase gradually (in 2008: 40 years of contributions) while the first one will remain unchanged.
2. **Unemployment-related ("Long mobility"):** after the exhaustion of the benefits (80% of the wage) for temporary lay-off paid out of the Wage Supplementation Fund (CIG-Cassa integrazione guadagni), workers that are dismissed (due to downsizing/restructuring or crisis of firms with more than 15 employees) can have access to the "mobility" scheme. Under the mobility scheme, the replacement rate is 80% in the first year and 65% (with thresholds) afterwards. The scheme can last up to 4 years in the Mezzogiorno (3 years in the rest of the country) for persons older than 50. This scheme can also be prolonged (the so-called "long mobility") for older workers until they can have access to "seniority" or "old-age" pension.

### *Luxembourg*

Eligibility rules for the disability pension scheme have been tightened, e.g. by putting more weight on medical examinations and measures for reintegration, preferably within the disabled worker's old firm. The accrual rates of pension rights for those over 55 years of age, who remain in employment, were raised (0.01% per each additional year in work, up to a maximum of 2.05) to reward those staying longer in the labour market. Two main schemes: 1) early-retirement (seniority scheme); 2) disability related scheme.

1. **Early-retirement/Seniority pension:** from 2002 this is possible for workers either 1) aged 57 and with at least 40 years of paid compulsory contributions or 2) aged 60, if the 40 years of paid contributions include voluntary contributions.
2. **Disability-conditional scheme:** Persons receiving a disability pension are obliged to follow rehabilitation measures until they reach the age of 50. From July 2002, employees who become unable to work in their current job due to health problems, but are not entitled to disability pension, will receive (after completing the maximum period for receiving the regular unemployment benefits) a provisional subsidy, whose amount is equivalent to the disability pension, until taking up a suitable job.

### **The Netherlands**

Current main schemes: 1) unemployment-related scheme; 2) early retirement scheme under collective labour agreements (VUT); 3) new early retirement scheme under collective labour agreements (flexible pension schemes); 4) partial retirement. (Although the proportion of older people (45-65) entering the disability scheme (WAO) is considerable, the scheme is not considered to be directly linked to early retirement-see Cardiff report).

1. **Unemployment-related scheme:** exemption from compulsory job-search for unemployed persons aged over 57.5
2. **Early retirement schemes in collective labour agreements (VUT):** scheme based on collective agreements (national, sector-based or company agreements), and financed by employees' contributions. They are not actuarially neutral. If employees do not avail themselves of the opportunity to retire earlier, they lose all accrual rights. This only concerns workers of the private sector. Regulations concerning criteria such as age, seniority or vary according to sectoral collective agreements. The retirement age is between 58 and 62, and the level of benefit lies between 70-90% of the final wage. The average retirement age in 2001 was 60.3. Tax incentives have been abolished.
3. **New early retirement scheme under collective labour agreements (flexible pension schemes):** many VUT schemes have been converted (with a transitional period) in new flexible schemes, which are actuarially neutral. The average retirement age in 2001 was 61.2. Tax incentives have been introduced.
4. **Partial retirement:** possible but little use is made of it.

### **Austria**

Following the reform in 2000, pension benefits are calculated on the basis of the best 15 years of salary (gradually raised to 18 years between 2003 and 2019 for early retirement pensions). The accrual rate is 2% (maximum replacement rate is 80% or 90% for delayed retirement, with accrual rates of 4%). The penalty for early retirement is equal to 3% per year before the normal retirement age (60 for women and 65 for men), with a maximum of either 10.5% of the earning of reference for the calculation of the pension or 15% of the pension. Current main schemes: 1) early retirement; 2) disability-conditional scheme; 3) unemployment-based early retirement; 4) partial retirement.

1. **Early retirement:** men aged at least 61.5 and women aged at least 56.5 (1.5 years more after the 2000 reform), with at least 40 years of paid contributions.
2. **Disability-conditional scheme:** the former early retirement scheme due to reduced working capacity was repealed in 2000. Currently, in case of temporary and partial invalidity (less than 50% of the normal physical and mental capacity), the invalidity or disability benefit is granted for at most 2 years plus an additional two years, in special cases of prolonged invalidity. The pension for limited ability is means-tested (no

eligibility if monthly income from work exceeds €907). Pension benefit is paid for unlimited period in case of permanent invalidity.

3. **Unemployment pension scheme:** unemployed men aged at least 61.5 and women aged at least 56.5, with at least 240 months of contribution and at least 52 weeks over the last 15 months of entitlement to unemployment benefits or others social transfers.
4. **Partial/gradual retirement:** possible for men aged at least 61.5 (55 for partial retirement) and women aged at least 56.5 (50 for partial retirement). This part-time scheme has turned out to be much more costly than expected, and has been largely used as a substitute for early retirement. Consequently, the government has announced its intention to reform the scheme.

### Portugal

Two main schemes: 1) early retirement with penalty; 2) unemployment-related scheme.

1. **Early retirement with penalty:** since 1999, early retirement is possible from age 55 and with 30 years of paid contributions. A ‘malus’ of 4.5% is applied for each year before the statutory retirement age (65 in the private sector, 60 in the public sector). No penalty is applied to people working in the public sector, provided that they have 36 years of paid contributions and to people in particular (“hard” conditions) jobs (miners, fishers, civil aviation pilots, air traffic controllers).
2. **Unemployment-related scheme:** long-term unemployed can anticipate their retirement to age 60 if they are unable to get unemployment benefits any longer.

### Finland

From 2005 there will be a flexible retirement age (62-68), with higher accrual rates for the later years in work. Current six schemes: 1) early retirement scheme; 2) disability-conditional scheme; 3) individual early retirement; 4) unemployment pension scheme; 5) partial retirement; 6) other early retirement schemes. Some reforms to the current schemes will take effect in 2005.

1. **Early retirement scheme:** eligibility at age 60 (5 years before the statutory age of 65). Actuarial reduction of 0.4 per each month of early retirement.
2. **Disability-conditional scheme:** persons aged 16-64, entitled to a full or partial disability pension. The amount is related to the previous pay level (last 10 years) and the length of work history, and the projected future work until age 65. The projected service is considered to extend from the insured event to the statutory retirement age of 65. The accrual rate for each year in work is the normal one (1.5% until age 60 and 2.5% thereafter in the private sector, 2% between 56-64 years in the public sector. Accrual rate for the projected service is up to the age of 50 1.5% per year, from 50 to 60 1.2% per year and from 60 to 65 0.8% per year. Indexation rule is: 50% to wages and 50% to prices.
3. **Individual early retirement (Disability-conditional scheme):** disability pension for persons aged 60-64, with eligibility criteria (health condition) less strict than in the general disability scheme (new pensions will not be granted after 2004).
4. **Unemployment pension scheme:** for long-term unemployed aged 60-64. Benefit levels are calculated approximately as in the old-age pension scheme. Eligibility criteria: employed for at least 5 out of the last 15 years, minimum age of 60, and having already received regular unemployment benefit for the maximum period of 500 days. This implies that people who become unemployed at the age of 55 or over can receive (extended) unemployment benefits (so called “unemployment pipeline”) until the age of 60 when they automatically receive an unemployment pension, and from the age of 65 they receive the regular old-age pension. The unemployment pension

scheme will be gradually phased out and replaced by an extension of the “unemployment pipeline” system from the current age of 60 to 65, but the minimum age of the latter will increase to age 57.

5. **Partial retirement:** possible for persons aged 56-64 years (from 2003 minimum age is 58 for those born after 1946). Part-time pension amounts to half the difference between previous full-time and part-time wage.
6. **Other early retirement schemes:** involve some occupations in the public sectors (nurses, police officers, train drivers, school teachers) during the 20 years of transitional period for old schemes, repealed in 1989. For these occupations, the early retirement age varies from 55 to 60 years. After 1995, the normal retirement age for public sector employees is 65, but varies from 63 to 65 for those born before 1960.

### **Sweden**

Since 2001 there is an actuarially neutral flexible retirement age from 61. Current 3 main schemes: 1) occupational pension agreements; 2) disability-conditional scheme; 3) partial retirement.

1. **Occupational pension** (collective labour agreements): early retirement provisions vary across agreements.
2. **Disability scheme:** persons aged 16-64, with a permanent disability, are entitled to a full or partial disability pension. The amount is made up of the national basic pension and the supplementary pension under the ATP (income –based) scheme. People with temporary disability only get a temporary sickness benefit. New system since January 2003: persons between 19 and 29 will get an “activity compensation” for no longer than 3 years. Persons aged 30-64 will get a sickness compensation, whose duration is related to that of their incapacity to work. Important is that the new system is part of the sickness insurance instead of the pension system.
3. **Partial retirement:** is possible from age 61 onwards in the new pension system. The partial pension system will be phased out in January 2005.

### **United Kingdom**

There is no early-retirement provision within the public pension schemes.

But, the **Minimum Income Guarantee** (to be transformed in Pension Credit in October 2003) can be claimed by men from age 60 without a work or job-search obligation (while women aged 60 get the regular public pension). Deferral of a public pension is possible for up to five years, with increased accrual rights. Earnings from work can be cumulated with a pension. Private occupational schemes can allow early-retirement, especially in case of redundancy, when actuarial adjustments are waived.

**Disability scheme:** The majority of inactive individuals aged between 50 and State Pension age are claimants of sickness or disability benefits, most of whom receive Incapacity Benefit.